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No.

In the Supreme Court of the United States

OCTOBER TERM, 1997

UNITED STATES OF AMERICA,
PETITIONER

v.

CONTINENTAL AIRLINES
THOMAS E. ROSS, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether, notwithstanding 11 U.S.C. 553(a)'s provision that "this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title," the confirmation of a bankruptcy reorganization plan under 11 U.S.C. 1141 causes a creditor to lose its setoff rights against the debtor.

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PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-14a) is reported at 134 F.3d 536. The opinion of the district court (App., *infra*, 18a-30a) is reported at 218 B.R. 324. The report and recommendations of the magistrate judge (App., *infra*, 31a-51a) and the decision of the bankruptcy court are unreported (App., *infra*, 52a-56a).

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1998, and was amended on March 23, 1998. A petition for rehearing was denied on March 23, 1998. On June 12, 1998, Justice Souter extended the time for filing a petition for a writ of certiorari to and including July 21, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 553 and 1141 of the Bankruptcy Code, 11 U.S.C. 553, 1141, are reproduced at App., *infra*, 65a-68a.

STATEMENT

1. In December 1990, Continental Airlines filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. Several federal agencies filed claims that totaled more than $14 million.[1] The debtor challenged many of those government claims as to their amounts and validity. To date, most of those challenges have not yet been resolved.

The claims filed by the various federal agencies followed different forms. The proof of claim filed on November 27, 1991, by the Federal Aviation Admini-

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[1] The claims were filed by the Immigration and Naturalization Service ($5,859,955.06), the United States Customs Service ($5,420,830), the Federal Aviation Administration ($3,405,700), the United States Postal Service ($42,275), the Department of Agriculture ($94,266.71), the United States Air Force ($155,572.89), the Department of Labor ($42,000), the Equal Employment Opportunity Commission ($3,500), the Drug Enforcement Administration ($837.50), and the Peace Corps ($934.90). See C.A. App. 58 (Attachment (Facts) to Bankruptcy Court Order dated Sept. 30, 1993); C.A. App. 50 (Proofs of Claim Filed on Behalf of the United States).

stration (FAA) stated: "The United States reserves its right to effect any and all appropriate setoffs." C.A. App. 40 (FAA Proof of Claim, Rider A). Neither the trustee nor any other party objected to or opposed the claim filed by the FAA, or challenged the expressed reservation of the setoff rights of the United States. Other claims did not expressly preserve the government's setoff rights. See App., *infra*, 32a-35a.

On April 16, 1993, the bankruptcy court confirmed respondent's reorganization plan. Under the plan, as unsecured creditors, the federal agencies were to receive payment equivalent to approximately 4.8 percent of their allowed claims. The Plan of Reorganization further provided that the Debtor and the new entity, "New Cal," could, but were not required to, exercise their own setoff rights available under applicable law. See C.A. Supp. App. B-50 (Debtor's Second Revised Amended Joint Plan of Reorganization ¶ 14.8). The plan did not provide for or mention the setoff rights of creditors.

2. In September 1990, before it filed for bankruptcy, Continental Airlines, together with several other airlines, filed an action in the U.S. District Court for the District of Columbia seeking to force the General Services Administration (GSA) to pay for air travel. GSA had withheld funds because of perceived overcharges by the airlines on past air travel. On August 11, 1992, the district court granted summary judgment in favor of the airlines.[2] The district court ordered GSA to return "all monies held

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[2] The court held that, although GSA has the right to audit ticket payments and to withhold funds based upon past overcharges, it could not conduct audits on the premise that the government was entitled to the lowest fare available.

improperly." *Alaska Airlines, Inc.* v. *Austin*, 801 F. Supp. 760 (D.D.C. 1992), aff'd in part, rev'd in part, 8 F.3d 791 (Fed. Cir. 1993).

When the district court refused to stay its order requiring GSA to pay the airlines, the United States sought a stay from the Federal Circuit. The court of appeals initially denied a stay. The United States filed a motion for partial reconsideration, pointing out that if it turned over the funds to the airlines in bankruptcy, it could lose the right to set off the funds against debts owed by the airlines to the United States. The United States asked for permission to pay the funds into the registries of the respective bankruptcy courts so that the funds could be held in escrow while the government asserted its setoff rights in bankruptcy court. In response to the United States' motion expressly seeking to preserve its setoff rights, the Federal Circuit issued an order on February 25, 1993, staying the district court's order to pay the airlines in bankruptcy. *Alaska Airlines* v. *Jones*, Nos. 93-1028, 93-1117, 93-1125 & 93-1161 (Fed. Cir. Feb. 25, 1993) (Order per Rich, J.). Then, on April 12, 1993, to afford the United States an opportunity to assert its setoff rights before turning the funds over to the airlines in bankruptcy, the Federal Circuit modified the district court's order and directed the United States to deposit the funds in the registries of the bankruptcy courts for the airlines then in bankruptcy proceedings. C.A. App. 26-27 (Federal Circuit Order dated April 12, 1993). Accordingly, on May 19, 1993, more than one month after the confirmation of the respondent's reorganization plan, the United States deposited $4,763,219.60 with the registry of the Bankruptcy Court for the District of Delaware. App., *infra*, 16a, 58a.

3. On May 28, 1993, the United States filed a motion in the bankruptcy court seeking permission, pursuant to 11 U.S.C. 553, to set off the deposited funds against Continental's prepetition debts to the United States. On September 30, 1993, the bankruptcy court denied the motion. The bankruptcy court held, *inter alia*, that the United States lost its setoff rights when the reorganization plan was confirmed. Relying upon *United States* v. *Norton*, 717 F.2d 767 (3d Cir. 1983), the bankruptcy court held that, under 11 U.S.C. 1141, upon confirmation of the plan all property of the estate vested in the newly-reorganized entity free and clear of any claims or interests. App., *infra*, 54a.

4. The government appealed the bankruptcy court's ruling to the district court. The district court referred the matter to a magistrate judge, who filed a report and recommendations agreeing with the bankruptcy court. App., *infra*, 31a-51a. On January 9, 1997, the district court issued an order affirming the decision of the bankruptcy court. App., *infra*, 18a-30a. Relying on *Norton*, *supra*, the district court held that, under 11 U.S.C. 1141, confirmation of a Chapter 11 plan extinguishes a creditor's right to setoff. App., *infra*, 29a.

5. The United States appealed to the United States Court of Appeals for the Third Circuit, and argued that the reasoning of *Norton* was inconsistent with the rationale of *Citizens Bank of Maryland* v. *Strumpf*, 516 U.S. 16 (1995). The government contended that, under *Strumpf*, funds held by a creditor that may be subject to a setoff right are not to be treated as "property of the estate." Hence, such funds do not vest free and clear in the reorganized debtor upon confirmation of a plan of reorganization.

The United States also contended that confirmation under Section 1141 cannot extinguish pre-petition setoff rights because Section 553 specifies that none of the Code provisions (except as provided therein) affect a creditor's setoff rights.

On January 20, 1998, the Third Circuit affirmed the district court's judgment. The court agreed that *Norton* "implicitly held that the funds withheld by the creditor subject to set-off were 'property of the estate,'" and that under *Strumpf*, "the relevant 'property of the estate' is instead the bankrupt debtor's claim to the funds as opposed to the possession of the physical funds themselves." App., *infra*, 7a-8a. The court distinguished *Norton* and *Strumpf* on the ground that, in both of those cases, "the creditor retained possession of the funds; here the Government deposited the $4.8 million into the registry of the court pending an appeal." App., *infra*, 8a. The court held that such funds "are comparable to the res of a trust," and that the government had no beneficial interest in the funds at that juncture. *Ibid.* The court explained that, under *Norton*, the government's setoff right was extinguished by the confirmation of the plan: "Although the actual funds themselves may not have passed as property of the estate, upon confirmation of the plan, [respondent] did acquire a claim or interest in them subject only to final resolution of the Government's appeal." *Ibid.*

The court reasoned that allowing the government to attempt to exercise its setoff right post-confirmation could disadvantage the other unsecured creditors, disrupt the plan of reorganization, and protract the bankruptcy proceedings. App., *infra*, 9a-10a. Thus, the court concluded, "we reaffirm the ruling in *Norton* and hold that the right of a creditor to set-off

in a bankruptcy reorganization proceeding must be duly exercised in the bankruptcy court before the plan of reorganization is confirmed; the failure to do so extinguishes the claim." *Id.* at 13a.

6. On March 5, 1998, the United States filed a timely petition for rehearing and suggestion for rehearing *en banc*. In the petition, the government argued that the court's ruling was legally erroneous, inconsistent with this Court's *Strumpf* decision, in conflict with decisions of the Ninth and Tenth Circuits, contrary to the prevailing view of the lower courts, and based upon several critical erroneous factual assumptions. One of the factual errors identified in the rehearing petition was that the court of appeals appeared to base its legal conclusion on the incorrect assumption that the $4.8 million was in the estate's possession prior to confirmation of the plan of reorganization. On March 23, 1998, the court of appeals amended its decision to reflect that those funds were in fact held by the government until after the confirmation of the plan. Compare App., *infra*, 16a with App., *infra*, 8a. On that same date, the court denied the petition and the suggestion for rehearing *en banc*. *Id.* at 61a-62a.

REASONS FOR GRANTING THE PETITION

The court of appeals held that a creditor's setoff rights must be asserted in the bankruptcy proceedings and that setoff rights not asserted or provided for in the reorganization plan are extinguished by a Section 1141 confirmation order. That decision is inconsistent with the plain language of Section 553, this Court's decision in *Citizens Bank of Maryland* v. *Strumpf*, 516 U.S. 16 (1995), and the majority of court decisions, including decisions of the Ninth and Tenth

Circuits. Because the issue is fundamental to the sound administration of the Nation's bankruptcy laws—for governmental and private creditors alike—the Court should grant review.

1. a. The right of setoff permits a creditor to deduct a debt it owes to a debtor from a claim the creditor has against the debtor arising out of a separate transaction. See 5 *Collier on Bankruptcy* ¶ 553.01 (15th rev. ed. 1998). It "allows parties that owe mutual debts to state the accounts between them, subtract one from the other and pay only the balance." *In re Bevill, Bresler & Schulman Asset Management Corp.*, 896 F.2d 54, 57 (3d Cir. 1990). Setoffs have been an established part of the law dating back to the Roman Empire and have been incorporated into American bankruptcy law consistently since 1800. See *In re Davis*, 889 F.2d 658, 661 n.5 (5th Cir. 1989), cert. denied, 495 U.S. 933 (1990); 5 *Collier on Bankruptcy*, *supra*, ¶ 553.LH. The rule is based upon the "common sense notion that 'a man should not be compelled to pay one moment what he will be entitled to recover back the next.'" *In re Davis*, 889 F.2d at 661 n.5 (quoting Lloyd, *The Development of Setoff*, 64 U. Pa. L. Rev. 541, 541 (1916)). See also *In re Patterson*, 967 F.2d 505, 508 (11th Cir. 1992). This Court recently explained:

> The right of setoff (also called "offset") allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding "the absurdity of making A pay B when B owes A."

Citizens Bank of Maryland v. *Strumpf*, 516 U.S. at 18 (quoting *Studley* v. *Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)).

In the bankruptcy context, without the right of setoff a creditor would have the "worst of both worlds." *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d 1269, 1277 (9th Cir.), cert. denied, 506 U.S. 918 (1992). Absent the setoff right, the creditor would have to pay the debtor in full, but would recover only a small portion of the fund it is owed. *Ibid.* To avoid that fundamental unfairness, Congress enacted Section 553 of the Bankruptcy Code. That provision specifically recognizes and preserves a creditor's setoff rights by stating that a creditor's setoff right for pre-petition mutual debts is *not* subject to the other Code provisions, except Sections 362 and 363 of the Code:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, *this title does not affect any right* of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case * * *.

11 U.S.C. 553(a) (emphasis added).

Section 553's instruction that "this title does not affect any right" of setoff on its face means that the other provisions of Title 11 (not mentioned in Section 553) simply do not affect a creditor's right to setoff. See *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d at 1276-1277. The court of appeals here held that the confirmation of a bankruptcy plan causes a creditor's claim to be discharged (except insofar as payment is provided for in the plan), and that the creditor's pre-petition setoff rights not provided for in the plan are extinguished upon confirmation. The

Code's provisions regarding discharge of debts and confirmation of reorganization plans, 11 U.S.C. 524, 1141, 1327, however, are *not* among the provisions listed in Section 553. See App., *infra*, 65a-66a. Because Section 1141 is omitted from the expressly specified provisions that create exceptions, the court of appeals' ruling conflicts with Section 553's general rule that a creditor's rights are not affected by the Bankruptcy Code.

b. Indeed, this Court has recognized that "Section 553(a) * * * sets forth a general rule, with certain exceptions, that any right of setoff that a creditor possessed prior to the debtor's filing for bankruptcy is not affected by the Bankruptcy Code." *Strumpf*, 516 U.S. at 20. Those "certain exceptions," the Court made clear, are those explicitly stated in the text of Section 553 "and in sections 362 and 363." *Ibid.* (quoting 11 U.S.C. 553(a)). The court below instead based its holding on Section 1141 of the Bankruptcy Code, which concerns the "property of the estate." See 11 U.S.C. 1141(b) ("Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."). The court of appeals reasoned that, because confirmation vested a property right in the debtor's estate, the creditor's setoff rights were thereby extinguished because the debtor had a claim to that property. App., *infra*, 7a-8a; 16a-17a.

The court of appeals' holding and rationale cannot be squared with *Strumpf*, *supra*. In *Strumpf*, a bank held funds subject to a setoff right. The estate argued that the bank's retention of the funds violated the Bankruptcy Code's automatic stay, which prohibits a creditor from exercising "dominion over property that belong[s] to the [estate]." 516 U.S. at 21. This

Court unanimously rejected that argument, holding that refusal to pay a debt subject to a right of setoff is not an exercise of control over property of the estate. The Court explained that the refusal to pay "was neither a taking of possession of [the debtor's] property nor an exercising of control over it, but merely a refusal to perform [the creditor's] promise." *Ibid.*[3] Hence, under *Strumpf*, funds held by a creditor subject to a setoff claim are not "property of the estate." Those funds, therefore, are not properly subject to a Section 1141 confirmation order that would take precedence over a Section 553 right of setoff.

The decision below relied on circuit precedent that pre-dated *Strumpf*. See App., *infra*, 7a-9a, 16a-17a (discussing *United States* v. *Norton*, 717 F.2d 767 (3d Cir. 1983)). *Norton* treated funds held by the creditor subject to a possible setoff right as "property of the estate." Accordingly, *Norton* concluded that such funds vested free and clear in the reorganized entity emerging from bankruptcy. After *Strumpf*, however, it is now clear that *Norton*'s fundamental premise was incorrect. Funds being held by the creditor at the time of confirmation are not "property of the estate." See 516 U.S. at 21. Thus, such funds do not vest free and clear in the reorganized debtor upon confirmation of the plan.

The court of appeals here conceded that *Norton*'s reasoning is incorrect in one respect in light of this Court's subsequent decision in *Strumpf*. App., *infra*,

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[3] The Court declined to address the issue raised in this petition, whether "confirmation of [the debtor's] Chapter 13 plan under 11 U.S.C. § 1327 precluded petitioner's exercise of its setoff right," because the respondent had not raised that contention in the courts below. See 516 U.S. at 21 n.*.

6a. On the government's petition for rehearing, the court further conceded that the basic factual predicate for its initial decision—that the funds had been transferred from the government to the court registry (and thereby, in the court's view, were part of the debtor's estate) prior to confirmation of the plan—was also incorrect. See App., *infra*, 16a. The court nonetheless adhered to the result in *Norton* that a creditor loses its setoff right upon confirmation. The court provided no cogent explanation for that conclusion, or how it can be reconciled with the language of Section 553 and this Court's decision in *Strumpf*. App., *infra*, 16a-17a.

2. The court of appeals' decision conflicts with those of the majority of other courts, which have held that neither confirmation of a reorganization plan nor discharge of a claim affects a creditor's setoff rights for mutual pre-petition debts. See *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d at 1276-1277; *In re Davidovich*, 901 F.2d 1533, 1539 (10th Cir. 1990); *In re South Park Care Assocs.*, 203 B.R. 445, 447-448 (Bankr. W.D. Mo. 1996); *In re Wiegand*, 199 B.R. 639, 641-642 (W.D. Mich. 1996); *In re Pettibone Corp.*, 161 B.R. 960 (N.D. Ill. 1993), aff'd in part, and remanded in part on other grounds, 34 F.3d 536 (7th Cir. 1994); *In re Buckner*, 218 B.R. 137, 144 (B.A.P. 10th Cir. 1998); *id.* at 149 (Matheson, Bankruptcy Judge, concurring); *In re Buckenmaier*, 127 B.R. 233, 236-237 (9th Cir. B.A.P. 1991); *In re Sedlock*, 219 B.R. 207, 209-210 (Bankr. N.D. Ohio 1998); *In re Holder*, 182 B.R. 770, 775 (Bankr. M.D. Tenn. 1995); *In re Womack*, 188 B.R. 259, 261-262 (Bankr. E.D. Ark. 1995). That conflict has been noted by the leading commentary on bankruptcy law, which has endorsed the majority position as the "better view" that confirmation and discharge

by a reorganization plan do not extinguish a creditor's setoff rights. 5 *Collier on Bankruptcy*, *supra*, ¶ 553.08[1]-[2].[4]

The court of appeals attempted to distinguish *In re De Laurentiis Entertainment Group* on the ground that the Ninth Circuit "predicated its decision upon the particular facts * * *, including the creditor's diligent pursuit of its set-off claim before the bankruptcy court." App., *infra*, 10a. The Ninth Circuit mentioned those facts, however, only *after* it had already ruled, as a matter of law and of statutory construction, that confirmation of a bankruptcy reorganization plan does not compromise a creditor's setoff rights. *In re De Laurentiis Entertainment Group*, 963 F.2d at 1276-1277. The Ninth Circuit explained that Section 553(a)'s "language not only establishes a right to setoffs in bankruptcy, subject to enumerated exceptions, but seems intended to control notwithstanding any other provision of the Bankruptcy Code." *Ibid.* "To give section 1141 precedence would be to ignore this language." *Id.* at 1277. Thus, the court held:

> We conclude that section 553 must take precedence over section 1141. In reaching this conclusion, we rely not only on the foregoing persuasive authority, but also on the language and structure of section 553 and the policies which underlie it.

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[4] For the "minority" view cases, see, *e.g.*, *United States* v. *Norton*, 717 F.2d 767, 774 (3d Cir. 1983); *In re Dezarn*, 96 B.R. 93, 94-95 (Bankr. E.D. Ky. 1988); *In re Hackney*, 20 B.R. 158, 159 (Bankr. D. Idaho 1982); *In re Holcomb*, 18 B.R. 839, 841 (Bankr. S.D. Ohio 1982); *In re Johnson*, 13 B.R. 185, 188-189 (Bankr. M.D. Tenn. 1981).

Id. at 1276. That holding is directly contrary to the court of appeals' decision in this case.

The Third Circuit's decision is also at odds with the Tenth Circuit's decision in *In re Davidovich*, 901 F.2d at 1538-1539. In *Davidovich*, the creditor asserting the setoff right did not file a proof of claim or assert its setoff right in the bankruptcy proceeding prior to the court's discharge order. Although *Davidovich* involved a Chapter 7 bankruptcy, the court's analysis is not limited to that context.[5] Whether the discharge order is under Section 524 (as in *Davidovich*) or under Section 1141 (as is the case here and in *De Laurentiis*), the relevant legal question is whether, notwithstanding the discharge of the debtor's personal obligations, the plain language of Section 553(a) controls and the creditor's setoff rights as to mutual pre-petition claims remain intact. On that question the Tenth Circuit held that, under Section 553(a), the Bankruptcy Code "does not affect" a creditor's setoff rights. *In re Davidovich*, 901 F.2d at 1539. The court concluded that a creditor need not file a claim to preserve a setoff right, and that "the right to assert a setoff against a mutual prepetition debt * * * survives even the Bankruptcy Court's discharge of the bankrupt's debts." *Ibid.*

3. By ignoring the clear language of Section 553(a) and adopting the minority view of the extinguishment of creditor's rights after confirmation of the debtor's plan, the court of appeals has significantly impaired creditors' rights in bankruptcy in several important respects.

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[5] Similarly, the court below concluded that Third Circuit precedent in *Norton* was not limited to the Chapter 13 context. See 717 F.2d at 774.

a. Under the Code, a creditor owing funds to the debtor is expressly permitted to retain the funds that are possibly subject to a setoff right. See 11 U.S.C. 542(b). The creditor may hold the funds without violating the automatic bankruptcy stay and wait for the debtor or estate to sue it to recover the funds. See *Strumpf*, 516 U.S. at 20-21. When the debtor or estate sues the creditor, the creditor may then raise the setoff as a defense. See *Newbery Corp.* v. *Fireman's Fund Ins. Co.*, 95 F.3d 1392, 1398 (9th Cir. 1996); *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d at 1277; *In re Davidovich*, 901 F.2d at 1539; 5 *Collier on Bankruptcy, supra*, ¶ 553.07[1]-[2].

By contrast, the court of appeals here held that the setoff right abates unless it is adjudicated before confirmation or preserved explicitly in the confirmed plan of reorganization. That ruling has the effect of preventing a creditor from retaining funds subject to a setoff claim and raising the setoff right as a defense when sued by the debtor, as the creditor is otherwise permitted to do under the Code. The holding below instead requires a creditor affirmatively to assert its setoff right in the bankruptcy proceeding, and mandates that the setoff defense will be lost if not provided for in the reorganization plan. App., *infra*, 13a. The Ninth Circuit specifically rejected that view, under which "setoffs would be allowed under Chapter 11 only where they were written into a plan of reorganization." *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d at 1277. By giving no effect to Section 553 unless a creditor affirmatively seeks to have its setoff rights expressly protected in the plan, the Third Circuit's rule would leave a creditor's setoff rights subject to the will of the other creditors

(who, like the debtor, would ordinarily have no incentive to grant the setoff rights).

As the Ninth Circuit has held, that result is tantamount to reading Section 55? out of the Bankruptcy Code. *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d at 1277 ("Section 553 would then be largely superfluous, since a setoff could be written into the plan even without section 553."). See also *In re Pettibone Corp.*, 161 B.R. at 964. No Code provision, however, requires the assertion of the setoff in a proof of claim or any other type of assertion of a setoff right in the bankruptcy court prior to confirmation.

b. The court of appeals' decision also rests upon a fundamental misunderstanding of the effect of a discharge under established principles of bankruptcy law. A discharge does *not* eliminate or extinguish a debt. It prohibits the creditor from enforcing it as a "personal liability" against the reorganized entity emerging from bankruptcy after discharge. See *Hall* v. *National Gypsum Co.*, 105 F.3d 225, 229 (5th Cir. 1997). Discharge of a debt does not prevent a creditor from enforcing the debt in other ways, such as against a co-signor, guarantor, or surety. See *In re Walker*, 927 F.2d 1138 (10th Cir. 1991). See also *Johnson* v. *Home State Bank*, 501 U.S. 78, 84 (1991) ("a bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*"). As to enforcement of a debt post-discharge, the "crucial inquiry" is whether the creditor is seeking to collect property of the estate that vested free and clear in the new entity. If so, the discharge order bars the collection. See *Hall*, 105 F.3d at 229. If not, the collection effort is entirely proper under the Code.

The assertion of a pre-petition setoff right against a pre-petition claim is not an attempt to collect affirmatively from the new entity. See *In re DeLaurentiis*, 963 F.2d at 1278; *In re Wiegand*, 199 B.R. at 641-642. Nor (as the court of appeals here conceded) is it an attempt to collect property that was in the estate at the time of the discharge order. Thus, as the Tenth Circuit has held, "the right to assert a setoff against a mutual, prepetition debt owed the bankrupt estate survives even the Bankruptcy Court's discharge of the bankrupt's debts." *In re Davidovich*, 901 F.2d at 1539; see also 5 *Collier on Bankruptcy*, *supra*, ¶ 553.08[1]-[2]. The decision below is directly to the contrary.

c. The court further erred in assuming that the assertion of a setoff right post-confirmation would disadvantage the other creditors and could disrupt the reorganization plan. See App., *infra*, 12a. Not only are those policy considerations insufficient to overcome the plain language of Section 553, they are incorrect in their own right. The reorganization plan approved in this case did not mention the *Alaska Airline* litigation or include proceeds from it as an asset. The plan did not distribute the *Alaska Airline* funds to the creditors or rely on the funds to support the reorganized debtor. C.A. Supp. App. B135-B138. Indeed, respondent apparently plans to keep those disputed funds for itself. Thus, permitting the government to assert a setoff right would not disadvantage any other creditor.

Nor was the court of appeals persuasive in suggesting that post-confirmation setoffs would protract bankruptcy proceedings. Chapter 11 bankruptcy proceedings do not end upon confirmation of the reorganization plan. The federal agencies have not yet

been paid anything on the bulk of their claims (which were duly filed in a timely fashion in the bankruptcy proceeding) almost *five years after confirmation* of respondent's plan, because the trustee's objections to the claims have not yet been adjudicated. Plainly, the bankruptcy proceedings here have not ended with the confirmation of the plan; allowing the United States to retain its setoff rights would not unduly delay the administration of the reorganization plan. Nor is this case factually unique in that respect. In any event, a creditor's post-confirmation assertion of setoff rights generally should not unduly delay the bankruptcy proceedings. A debtor can always force the creditor's hand by suing the creditor for the funds and thereby require the creditor to assert the setoff defensively before the funds are turned over.

Indeed, not only was the court incorrect in assuming that other creditors and the bankruptcy process itself would suffer, its decision places an unjustified and disproportionate burden on creditors that have setoff rights—whether they are private or public entities. Debtors will have every incentive to omit any reference to setoff rights in the plan and to do nothing about setoff until the plan is confirmed. Other creditors will not know of the funds the debtor plans to obtain after confirmation, and the plan will not provide for their distribution to creditors. Only the reorganized debtor stands to benefit from the extinguishment of a creditor's setoff rights. The decision below would allow debtors to obtain assets to which they had no right at the time of the bankruptcy filing and would ensure that those assets will not be distributed pursuant to the plan. As a result, creditors would have to monitor all plans of reorganization and object to every plan that does not contain an

express preservation of their setoff rights. Such a requirement would needlessly protract bankruptcy proceedings and require the expenditure of scarce resources. This Court should not countenance such an unwarranted departure from the express statutory scheme Congress has provided.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 1998

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 97-7109
Civil Action No. 93-cv-00485

IN RE: CONTINENTAL AIRLINES, DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

CONTINENTAL AIRLINES

THOMAS E. ROSS, TRUSTEE

An Appeal from the United States District Court
for the District of Delaware

Argued December 2, 1997
[Filed: January 20, 1998]

Before: COWEN, MCKEE and ROSENN, Circuit Judges.

OPINION OF THE COURT

ROSENN, Circuit Judge.

This appeal presents an issue pertaining to the right of set-off by a pre-bankruptcy creditor after a plan of reorganization has been approved by the bank-

ruptcy court. Continental Airlines and its affiliates (Continental or Debtors) filed petitions for reorganization under Chapter 11 of the Bankruptcy Code. In April, 1990, the bankruptcy court confirmed the Debtors' Joint Plan of Reorganization. In addition to ten federal government agencies that had timely filed proofs of claim, the General Services Administration of the United States (GSA or Government) filed an amended proof of claim on May 25, 1993, after the confirmation of the plan, and specifically asserted a right of set-off for the first time. The bankruptcy court held that the Government could not exercise set-off rights with respect to $4.8 million due the Debtor and ordered it to pay the sum to the Debtors. The Government appealed to the United States District Court for the District of Delaware which affirmed. The Government then timely appealed to this court.[1] We also affirm.

I.

On December 3, 1990, Continental filed for Chapter 11 reorganization in the United States Bankruptcy Court for the District of Delaware. Subsequently, each of ten agencies of the United States Government filed separate proofs of claim with the bankruptcy court for monies owed to them by Continental, which in aggregate totaled approximately $14.5 million. Continental submitted its revised final reorganization plan to the bankruptcy court on January 13, 1993. Although the court resolved several objections by the

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[1] The bankruptcy court had jurisdiction over this matter pursuant to 28 U.S.C. § 157(b). The district court had jurisdiction to review the bankruptcy court's decision pursuant to 28 U.S.C. § 158(a). This Court has appellate jurisdiction of the district court's order pursuant to 28 U.S.C. § 1291.

various agencies to Continental's proposed plan, no government agency sought to amend its proofs of claim to assert any additional claims, including a right to set-off the $4.8 million owed by GSA. Accordingly, the bankruptcy court entered its order confirming the plan on April 16, 1993 without any objection from the Government.

Under the confirmed plan, the federal agencies were treated as general unsecured creditors, and were entitled to recover approximately 4.8% of their total claims. The Government did not appeal the confirmation order. Meanwhile, in August 1992, in a suit unrelated to Continental's bankruptcy petition, the United States District Court for the District of Columbia ordered GSA to return money it had wrongfully withheld from several airlines, including approximately $4.8 million withheld from Continental.[2] The Government sought a stay of the district court's order in the United States Court of Appeals for the Federal Circuit. On April 12, 1993, the Federal Circuit issued an order denying the Government's request for a stay, but instead permitted it to deposit the disputed sum into the registry of the bankruptcy court while the Government attempted to set-off the $4.8 million it owed against the $14.5 million in claims due its agencies.

Subsequently, on May 28, 1993, the GSA filed a motion with the bankruptcy court seeking to set-off its claim against the funds deposited in the bankruptcy court's registry. On September 30, 1993, the

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[2] *Alaska Airlines, Inc. v. Austin*, 801 F.Supp. 760 (D.D.C. 1992). The facts of *Alaska Airlines, Inc. v. Austin* are not relevant to the issues raised on this appeal.

bankruptcy court denied the Government's motion, ruling that the Government could not exercise its set-off rights with respect to the $4.8 million and ordered it to pay the money to the Debtor. After the Government appealed, the District Court for the District of Delaware affirmed the bankruptcy court's ruling.

II.

This Court's review of a district court's disposition of a bankruptcy appeal is plenary. The Court of Appeals exercises "the same review of the district court's decision as that exercised by the district court. The bankruptcy court's findings of fact are reviewable only for clear error. Legal determinations are subject to plenary review." *In re Continental Airlines*, 125 F.3d 120, 128 (3d Cir. 1997) (internal citations omitted); *accord In re Engel*, 124 F.3d 567, 571 (3d Cir. 1997).

The Government argues that the $4.8 million it deposited into the registry of the bankruptcy court and which the Government alleged it was entitled to set-off[3] against the $14.5 million owed by Continental, was not "property of the [bankruptcy] estate." The

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[3] 11 U.S.C. § 553 which governs set-offs does not define the term. The right of set-off, as generally understood, simply means that "the debts of two persons who are mutually indebted may be set off against each other." Brian A. Blum, *Bankruptcy and Debtor/Creditor* § 22.2, at 348 (1993). "Its central premise is an ancient one well-grounded in practical logic: If A is indebted to B, and B is likewise indebted to A, it makes sense simply to apply one debt in satisfaction of the other rather than require A and B to satisfy their mutual liabilities separately." 5 *Collier on Bankruptcy* ¶ 553.01 (Lawrence P. King ed., 15th rev. ed. 1997).

Government contends that the bankruptcy court's confirmation of Continental's reorganization plan did not extinguish its right of set-off vis-a-vis the $4.8 million held in the court's registry.[4] The Government principally bases its argument on *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 116 S. Ct. 286, 133 L.Ed.2d 258 (1995), which it argues overrules this Court's holding in *United States v. Norton*, 717 F.2d 767 (3d Cir. 1983), heavily relied on by the bankruptcy court and the district court.

Norton held that a creditor's withholding of funds subject to a set-off violated the Bankruptcy Code's automatic stay provision,[5] and also adopted the viewpoint that set-off is not permitted *after* confirmation of a bankruptcy plan of reorganization. In *Norton*, under facts similar to those presented on this appeal, this court held that the Government could not offset an outstanding tax refund against an outstanding tax liability after confirmation of the debtor's plan. In their plan, as here, the debtors made no provision for set-off. Emphasizing that the Government never objected to the plan, we concluded that it would be unreasonable for the Government to retain the tax refund as security for the debtors' obligation. In-

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[4] For purposes of this discussion it is unnecessary to determine whether the Government did have a valid right of set-off; thus, the right will be assumed.

[5] The automatic stay, 11 U.S.C. § 362(a), is "an injunction that arises by operation of law immediately upon the commencement of the bankruptcy case . . . . Its effect is to impose a wide-ranging prohibition on all activity outside the bankruptcy forum to collect pre-petition debts from the debtor or to assert or enforce claims against the debtor's pre-petition property or estate property." Blum, *Bankruptcy and Debtor/Creditor* § 16.1, at 231.

stead, we required the Government to pay over the refund and accept treatment under the plan as an unsecured creditor.

The Government primarily contends that this case is closely analogous to and governed by the recent decision of the United States Supreme Court in *Strumpf* and thus is not controlled by *Norton*. In *Strumpf*, the Supreme Court merely held that a bank's *pre-confirmation temporary* withholding of a debt that it owed a depositor who was in bankruptcy, in order to protect its set-off rights, did not violate the automatic stay. The Court explained that the bank's "temporary refusal to pay was neither a taking of possession of [the depositor/debtor's] property nor an exercising of control over it, but merely a refusal to perform its promise." *Id.* at 21, 116 S. Ct. at 290. *Norton*, therefore, is only overturned to the extent that it held that "*state* law . . . determine[s] when a set-off has occurred." 717 F.2d at 772 (emphasis added). Today, under *Strumpf*, "the question whether a set-off . . . has occurred is [now] a matter of *federal* law;" a bank's temporary withholding of funds on deposit subject to a set-off does not violate the automatic stay. 516 U.S. at 18-20, 116 S. Ct. at 289 (emphasis added). The Government's position, in this case, mischaracterizes and overemphasizes both the relevance and importance of *Strumpf*. It reaches this conclusion by incorrectly arguing that pursuant to *Strumpf*, because the $4.8 million was still held in the registry of the Court at the time Continental's reorganization plan was confirmed, "the funds plainly were not 'property of the estate' at that time." Thus, the Government's argument continues, when the court confirmed the plan, the funds did not vest "free

and clear" in Continental as property of the bankruptcy estate. Building on this premise, the Government concludes that the April 16, 1993 confirmation of Continental's plan did not extinguish GSA's right to set- off the $4.8 million owed to Continental against its $14.5 million in claims due its agencies.

As Continental points out, however, the Supreme Court in *Strumpf* expressly refused to address the issue of the effect of confirmation on set-offs, which is dispositive to the resolution of this appeal. In a footnote in *Strumpf*, the Supreme Court unequivocally "decline[d] to address [the] contention . . . that the confirmation of [a bankruptcy reorganization plan] preclude[s][the] exercise of [a] set-off right." 516 U.S. at 21 n. **, 116 S. Ct. at 290 n. **. This case, therefore, is not controlled by *Strumpf* because the Government here filed its motion to exercise its alleged set-off in the bankruptcy court almost six weeks *after* confirmation of Continental's reorganization plan (and over nine months after the district court held the Government liable to Continental for the $4.8 million in the *Alaska Airlines* case).

Finally, the Government's contention that the *Norton* court "incorrectly considered the funds held by the creditor to be property of the estate" which led to its "erroneous ruling that confirmation of the plan extinguishes a creditor's set-off rights" is without merit. (citing 11 U.S.C. §§ 1141(b), 1327, and *Norton*, 717 at 774). The Government's argument makes two critical mistakes and thus misses the cumulative effect of the *Norton* and *Strumpf* holdings. First, although *Norton* implicitly held that the funds withheld by the creditor subject to set-off were

"property of the estate," today under *Strumpf*, the relevant "property of the estate" is instead the bankrupt debtor's claim to the funds as opposed to the possession of the physical funds themselves.

Second, the relevant funds at issue in this case are clearly distinguishable from those in both *Norton* and *Strumpf*. In both of those cases, the creditor retained possession of the funds; here the Government deposited the $4.8 million into the registry of the court pending an appeal. As this Court has noted, such deposits are comparable to the res of a trust. The "court acts as trustee and is charged with the duty of determining the beneficiaries pursuant to the appeal. . . . [T]he [Government] has no beneficial interest [in the deposit[]) [while the court] holds the money as . . . trustee for the rightful owners when and if they are determined by the court." *Mid-Jersey Nat'l Bank v. Fidelity-Mortgage Investors*, 518 F.2d 640, 643-44 (3d Cir. 1975). Thus, contrary to the Government's assertion, its set-off rights in the funds did not remain unaffected by confirmation of the plan because the Government no longer retained an interest in them; under *Norton*, its set-off right was extinguished by the confirmation of the plan. Although the actual funds themselves may not have passed as property of the estate, upon confirmation of the plan, Continental did acquire a claim or interest in them subject only to final resolution of the Government's appeal. *Norton* continues to have vitality and survives *Strumpf*.

The Government argues before us, however, that to the extent that *Norton* may control and hold that the confirmation of the plan extinguishes all set-off rights not provided for in the plan, it was wrongly de-

cided. The Government asserts that the Bankruptcy Code's set-off provision in § 553 states in the clearest of terms that the rest of the Bankruptcy Code "does not affect" a creditor's right to set-off provided that the obligations between creditor and debtor are mutual and that both obligations arose prior to the commencement of the reorganization proceedings. Relying on 11 U.S.C. § 553(a), the Government, in effect, maintains that a pre-petition creditor's right to set-off may be exercised without regard to the status of the bankruptcy proceedings and the confirmation of the debtor's reorganization plan. The Government argues that *In re De Laurentiis Entertainment Group, Inc.*, 963 F.2d 1269 (9th Cir. 1992), supports its position. In *De Laurentiis*, the court considered the tension between 11 U.S.C. § 553 and 11 U.S.C. § 1141 of the Bankruptcy Code. Section 1141 provides for the discharge of pre-petition debts after completion of a bankruptcy proceeding.[6] It also provides that any as-

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[6] 11 U.S.C. § 1141 provides in pertinent part:

> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind . . . any creditor . . . whether or not such creditor . . . has accepted the plan.
>
> . . .
>
> (c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, *the property dealt with by the plan is free and clear of all claims and interests of creditors* . . . .
>
> (d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the *confirmation of a plan—*

sets retained under the administration of reorganization are free and clear of any pre-petition debts. 11 U.S.C. § 553[7] protects the right of a creditor to offset a mutual debt. After analyzing the statutory sections and the applicable cases in other jurisdictions, the *De Laurentiis* court concluded that § 553 must take precedence over § 1141. Although uncertain, it also believed that the language of § 553 "seems intended to control notwithstanding any other provisions of the Bankruptcy Code." 963 F.2d at 1276-77. The court, however, predicated its decision upon the particular facts in the case before it, including the creditor's diligent pursuit of its set-off claim before the bankruptcy court "during the entire period the reorganization plan was being considered. *Id.* at 1277. The court noted that the creditor, NBC, had filed a proof of claim and petition for relief from stay.

We believe that the material facts in *De Laurentiis* distinguish it from the case before us. We recognize that a right of set-off is preserved under § 553 in a bankruptcy proceeding but we believe that the right must be exercised by the creditor in timely fashion and appropriately asserted in accordance with other

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(A) *discharges the debtor from any debt that arose before the date of such confirmation* . . . . (emphasis added).

[7] 11 U.S.C. § 553 provides in pertinent part:

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, *this title does not affect any right of a creditor to offset a mutual debt* owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . . (emphasis added).

provisions of the Bankruptcy Code. Unlike the Government in this case, NBC, the creditor in *De Laurentiis*, timely filed its proof of claim in the bankruptcy court and claimed its right of set-off against its debt to the Debtor. NBC also filed a motion for relief from the automatic stay prior to confirmation of the plan. The Government did neither of these in this case. In the instant case, the plan of reorganization proceeded on the justifiable assumption that the reorganized debtor faced no set-off claim. On the other hand, in *De Laurentiis*, the bankruptcy court converted NBC's set-off claim into an adversary proceeding and NBC "pursued its claim diligently before the bankruptcy court at all times." *Id.* at 1271. There was no adversary proceeding here prior to plan confirmation, and the facts in both cases are materially different.

The Government also cites to *In re Davidovich*, 901 F.2d 1533 (10th Cir. 1990) and two bankruptcy court cases. *Davidovich* involved an arbitration debt to the debtor from his former law partner, and the debtor, under the facts of the case, had notice of the set-off claim. The court, however, only discussed the right of set-off under § 553 but made no analysis of the provisions of § 1141 of the Bankruptcy Code. As to the bankruptcy court cases, *In Re Wiegand*, 199 B.R. 639 (Bankr. W.D. Mich. 1996) relies largely on *De Laurentiis* only, and the facts of *In re Womack*, 188 B.R. 259 (Bankr. E.D. Ark. 1995), are distinguishable. *Womack*, unlike this case, involved a *secured debt* of the Government, income tax liability, payment of which was provided by the confirmed plan. The debtors had a refund due from the Government for an overpayment on a subsequent tax year. After the

confirmation of the plan, the Government sought to set-off the refund against the debt due it under the plan and the bankruptcy court permitted it. The bankruptcy court concluded that the set-off might in fact be of benefit to the debtors and to some of the creditors because the reduction of the claim of the United States under the plan will permit acceleration of payment to other creditors. *Id.* at 262. Because the plan provided for the ultimate payment of the debt due the Government, allowing the set-off merely accelerated its payment, and there was no need to discuss the conflict between § 553 and § 1141 of the Bankruptcy Code.

Thus, we are not persuaded by the cases relied on by the Government that § 1141 may be disregarded when a set-off is asserted. *Norton* did not extinguish non-secured set-off claims, nor do we, provided they are timely asserted. In the instant case, the Government would have the court treat a non-secured claim as a secured claim to the disadvantage of all other general creditors. The Government here has no statutory secured claims as it did in *Womack* for income tax liability. Furthermore, allowing the Government under the facts of this case to come forward after the plan of reorganization has been confirmed and *sua sponte* decide that it has a valid set-off without timely filing a proof of claim and asserting the set-off in the reorganization proceedings, has a probability of disrupting the plan of reorganization. It may also unnecessarily protract the bankruptcy proceedings and consume judicial resources. Furthermore, it is unfair to other creditors and the debtors, and can conceivably undermine the plan of

reorganization and the objectives and structure of the Bankruptcy Code.

Thus, because the Government attempted to exercise its set-off right *after* confirmation of the plan, the Government's remaining arguments are unpersuasive. *Norton* still controls in this Circuit and precludes the Government's exercise of any set-off right it may have had once Continental's plan was approved. As the Government correctly notes, "a panel of this court is bound to follow the holdings of published opinions of prior panels of this court unless overruled by the court en banc or the holding is undermined by a subsequent Supreme Court case." *Nationwide Ins. Co. v. Patterson*, 953 F.2d 44, 46 (3d Cir. 1991).

III.

To summarize, we reaffirm the ruling in *Norton* and hold that the right of a creditor to set-off in a bankruptcy reorganization proceeding must be duly exercised in the bankruptcy court before the plan of reorganization is confirmed; the failure to do so extinguishes the claim.

Accordingly, the judgment of the district court upholding the bankruptcy court's ruling that the

Government's set-off rights, if any, were extinguished upon confirmation of Continental's Plan of Reorganization will be affirmed. Costs taxed against the appellant.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 97-7109
Civil Action No. 93-cv-00485

IN RE: CONTINENTAL AIRLINES, DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

CONTINENTAL AIRLINES

THOMAS E. ROSS, TRUSTEE

An Appeal from the United States District Court
for the District of Delaware

[Filed: March 23, 1998]

Before: COWEN, MCKEE and ROSENN, Circuit Judges.

ORDER AMENDING OPINION

The Opinion of the court filed in the above entitled case on January 20, 1998, is herewith amended as follows:

1) Slip opinion, page 4, second full paragraph, the first two sentences should now read as follows:

> The Government argues that the $4.8 million in funds it held at the time of confirmation and

> subsequently deposited into the registry of the bankruptcy court, and which the Government alleged it was entitled to set-off[] against the $14.5 million owed by Continental, was not "property of the [bankruptcy] estate." The Government contends that the bankruptcy court's confirmation of Continental's reorganization plan did not extinguish its right of set-off vis-a-vis the $4.8 million in funds because it still held them at the time of confirmation.[]

2) Slip opinion, page 6, line 7, delete "in the registry of the court" and substitute "by the Government."

3) Slip opinion, pages 6-7, revised and combine the last paragraph on page 6 and the first full paragraph of page 7 to read:

> Finally, the Government's contention that the *Norton* court "incorrectly considered the funds held by the creditor to be property of the estate" which led to its "erroneous ruling that confirmation of the plan extinguishes a creditor's set-off rights" is without merit. (citing 11 U.S.C. §§ 1141(b) and 1327, and *Norton*, 717 at 774). The Government's argument thus misses the cumulative effect of the *Norton* and *Strumpf* holdings. Although *Norton* implicitly held that the funds withheld by the creditor subject to set-off were "property of the estate" today under *Strumpf*, the relevant "property of the estate," is instead the bankrupt debtor's claim to the funds as opposed to the possession of the physical funds themselves. Even though the actual funds themselves may not have passed as property of the bankruptcy estate, upon confirmation of the plan, Continental did

acquire a claim or interest in them subject only to final resolution of the Government's appeal. Thus, contrary to the Government's assertion, its set-off rights in the funds did not remain unaffected by confirmation of the plan because, under *Norton*, its set-off right was extinguished by the confirmation of the plan. *Norton* continues to have vitality and survives *Strumpf*.

BY THE COURT:

/s/ MAX ROSENN
MAX ROSENN
Circuit Judge

March 23, 1998

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Nos. 90-322 to 90-984
Civ.A. No. 93-485-LON

IN RE: CONTINENTAL AIRLINES, INC., ET AL., DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

CONTINENTAL AIRLINES, INC., ET AL., APPELLEE

[Filed: Jan. 9, 1997]

ORDER

1. This matter comes before the Court on appeal from Orders of the United States Bankruptcy Court for the District of Delaware denying the United States's motion for an order directing the return of monies deposited with the Registry of the Bankruptcy Court and granting Continental's cross-motion for an order directing disbursement of the monies deposited with the Registry. [Docket Item ("D.I.") 14, at A-168 to A-174]. The matter was referred to the Honorable Mary Pat Trostle, United States Magistrate-Judge pursuant to 28 U.S.C. § 636(b) for the purpose of obtaining a report and recommendation to aid this Court in its disposition of this matter. [D.I. 20]. The Magistrate-Judge issued her Report and Recommendation recommending affir-

mance of the Orders of the Bankruptcy Court. [D.I. 22]. The Government filed objections to the Report and Recommendation. This Court will therefore conduct a de novo review of the Magistrate-Judge's Report and Recommendation. 28 U.S.C. § 636(b)(1).

2. On December 3, 1990, Continental filed a petition for reorganization under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. On April 16, 1993, the Bankruptcy Court entered an Order confirming Continental's Revised Second Amended Joint Plan of Reorganization ("Plan of Reorganization" or "Plan"). Prior to confirmation of the Plan of Reorganization, ten agencies of the United States filed proofs of claim against Continental. This appeal arises from the attempt by the United States to setoff certain funds the General Services Administration ("GSA") was ordered to pay to Continental in an unrelated matter against debts which Continental owed to these agencies.

3. In prior litigation, Continental and several other airlines commenced an administrative proceeding before the Comptroller General challenging GSA's policy and practice regarding government travel. The Comptroller General ruled in favor of the airlines, concluding that GSA had wrongfully withheld funds from the airline. GSA refused to abide by the ruling, claiming that the Comptroller General lacked constitutional authority to issue a binding decision. Consequently, the airlines filed suit in the United States District Court for the District of Columbia in *Alaska Airlines, Inc. et al. v. Richard Austin, et al.*, 801 F.Supp. 760 (D. D.C. 1992), to enforce the Comptroller's decision.

4. On August 11, 1992, the court ruled in the airlines favor and entered an injunction which, inter alia, ordered GSA to return money improperly withheld from the airlines. *See Alaska Airlines, Inc., et al. v. Richard Austin, et al.*, 801 F.Supp. 760 (D. D.C.1992), *rev'd in part on other grounds*, 8 F.3d 791 (Fed. Cir. 1993). Following the issuance of the injunction, the United States moved in the District Court of the District of Columbia for a stay pending its appeal. This motion was denied. The United States appealed this denial to the United States Court of Appeals for the Federal Circuit. In an Order dated February 10, 1993, the Federal Circuit also denied the United States's motion. On reconsideration, at the request of the United States, the Federal Circuit ordered GSA to pay the money withheld from Continental and three other airlines in bankruptcy proceedings into the registry of the respective bankruptcy courts rather than to the trustees. In accordance with the Federal Circuit's Order, on May 19, 1993, the United States deposited approximately $4.5 million in the Registry of the Bankruptcy Court for the District of Delaware.

5. On May 28, 1993, the United States moved in the Bankruptcy Court in the present action for an order directing the return of the money deposited in the Registry as a setoff against the debts owed by Continental to the various agencies of the United States that filed proofs of claims in this case. Continental opposed this motion and filed a cross-motion for disbursement of the funds. After a hearing, the Bankruptcy Court denied the United States's motion and granted Continental's cross-motion. This Court has

jurisdiction over the United States's appeal from these Orders pursuant to 28 U.S.C. § 158(a).

6. As a preliminary matter, the United States objects to this Court's referral of this case to the Magistrate-Judge. Pursuant to 28 U.S.C. § 636(b), this Court assigned this case to the Magistrate-Judge for the purpose of obtaining a report and recommendation to aid this Court in its decision of this matter. The United States asserts that it is improper for a district court to refer bankruptcy appeals to a magistrate-judge.

7. Resolution of this issue requires an examination of the modern procedural changes in the United States Bankruptcy Court system. The previous bankruptcy law, enacted as part of the Bankruptcy Reform Act of 1978 ("BRA"), expressly prohibited the district courts from referring appeals of bankruptcy court decisions to magistrate-judges. Under that system, 28 U.S.C. § 1334(c) provided: "A district court may not refer an appeal . . . to a magistrate or to a special master." This system also provided for three avenues of appeal from orders of bankruptcy judges: (1) to a panel of three bankruptcy judges; (2) to the United States district courts; or (3) directly to the courts of appeals, provided the parties agreed. *See* 1 Collier on Bankruptcy § 3.03(1)(a) (1996).

8. In response to the United States Supreme Court's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), which raised doubts about the constitutionality of the bankruptcy court system established by the BRA, Congress amended the bankruptcy court system through the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). The

BAFJA, inter alia, completely rewrote section 1334. By rewriting this section, Congress repealed the prohibition against referral to a magistrate-judge by omission. The BAFJA also reduced the avenues of appeal from the order of a bankruptcy judge from three to two. Under 28 U.S.C. § 158, a party may appeal an order of a bankruptcy court (1) to a district court; or (2) to panel of three bankruptcy judges.

9. The United States relies on the decisions in *Minerex Erdoel, Inc. v. Sina, Inc.*, 838 F.2d 781 (5th Cir.), *cert. denied sub.nom. Baker, Smith & Mills v. Minerex Erdoel, Inc.*, 488 U.S. 817 (1988), and *In re Elcona Homes Corp.*, 810 F.2d 136 (7th Cir. 1987) in challenging the propriety of referring this bankruptcy appeal to the Magistrate-Judge. These cases, however, are both distinguishable from the situation before the Court. In both of those cases, the district court referred the bankruptcy appeal to the magistrate-judge pursuant to 28 U.S.C. § 636(c)(1). *See Minerex*, 838 F.2d at 782 n. 1; *Elcona Homes*, 810 F.2d at 138. Under section 636(c)(1), a magistrate-judge, upon consent of the parties, "may conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case, when specifically designated to exercise such jurisdiction by the district court. . . ." Thus, in both of those cases, the magistrate-judge entered the final order in the case with no consideration or review from the district court. This was found to be contrary to the language in section 158 which clearly delineates the possible routes of appeal. The Court of Appeals for the Fifth Circuit opined:

> We are firmly convinced that § 158 can and must be taken at face value. Section 158 provides an

> intricate, balanced, and elaborate scheme for bankruptcy appeals carefully and thoughtfully crafted by Congress. Under that scheme appeals could be taken to (I) the District Court or (ii) to a panel of bankruptcy judges. No other type or kind of appeal was recognized, acknowledged, or permitted under that scheme. . . . It is reasonable to conclude that had Congress meant for its appeals scheme to include the potential for reference to a magistrate, Congress would have expressly so provided. Congress did not do so. Congress intended for its § 158 scheme to be comprehensive and complete in itself, and the avenues which it expressly provided to be the exclusive routes for bankruptcy appeals.

Minerex, 838 F.2d at 786 (footnote omitted); *accord Elcona Homes*, 810 F.2d at 139.

10. Conversely, in this case, the referral to the Magistrate-Judge was made pursuant to section 636(b). Unlike the situations described above, the Magistrate-Judge's decision is merely advisory, and the final order will be issued by this Court after de novo review of the Magistrate-Judge's Report and Recommendation. This distinction has been found to be critical by every post-BAFJA court reviewing this issue.[1] *See Virginia Beach Fed. Sav. and Loan Ass'n*

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[1] In *Clarkson v. Cooke Sales and Serv. Co.*, 767 F.2d 817 (8th Cir. 1985), a case initiated before the enactment of the BAFJA, the Court of Appeals for the Eighth Circuit commented that referral to the magistrate for a report and recommendation was improper under the BRA jurisdictional statute, 28 U.S.C. § 1334, which expressly forbade assignment to the magistrate. Because the provision relied on by the Eight Cir-

v. Wood, 901 F.2d 849, 851 (10th Cir. 1990); *Hall v. Vance*, 887 F.2d 1041, 1045-46 (10th Cir. 1989); *In re Apex Oil Co.*, 146 B.R. 821, 822-23 (E.D. Mo. 1992). As the Court of Appeals for the Tenth Circuit stated,

> In this case, the district court's order specifically states that the hearing before the magistrate would be advisory and that its purpose was "to further define and focus the issues on appeal." The district court explicitly reserved for itself the final decision on appeal. The district court, therefore, properly availed itself of the magistrate's assistance to hasten its handling of the case. By reserving for itself the final decision of the appeal, it avoided the error of the district court in Elcona Homes. We, therefore, must reject the . . . contention that the district court's referral was improper.

Hall, 887 F.2d at 1046.

11. This Court agrees with each of the other courts that have addressed this issue that referral to the Magistrate-Judge for an advisory report and recommendation pursuant to section 636(b) is not improper under the BAFJA bankruptcy system. Under 28 U.S.C. § 636(b)(3), this Court may assign a magistrate "such additional duties as are not inconsistent with the constitution and laws of the United States." With the deliberate repeal of the prohibition against such referrals in the BAFJA, there is no longer a conflict between the practice of referring bankruptcy appeals to the magistrate-judge and an express provision of law. Moreover, because the district court

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cuit was subsequently repealed by Congress, the reasoning in that case is inapposite to decision in this matter.

conducts a de novo review of the report and recommendation on referrals made pursuant to section 636(b), such referrals are not inconsistent with the section 158 language authorizing the district court to hear bankruptcy appeals. Accordingly, this Court concludes that it was not improper to refer this case to the Magistrate-Judge pursuant to section 636(b) for the purpose of obtaining an advisory report and recommendation to aid this Court in its decision of this matter.[2]

12. The United States also objects that the Magistrate-Judge applied an incorrect standard of review. This argument is primarily based on the United States assertion that the right of setoff under 11 U.S.C. § 553 is a matter of law, subject to de novo review. The United States is mistaken. The Court of Appeals for the Third Circuit has clearly stated that the grant of the equitable right of setoff rests in the discretion of the court. *United States ex rel. Internal Revenue Service v. Norton*, 717 F.2d 767, 772 (3d Cir. 1983). The Third Circuit opined:

> section 553 of the Bankruptcy Code neither defines "setoff" nor explains when a setoff has occurred. Thus, this provision is not an independent source of law governing setoff; it is generally understood as a legislative attempt to preserve the common-law right of setoff arising out of non-bankruptcy law. . . . The broad equitable discretion of courts in recognizing setoff rights

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[2] Because the referral to the Magistrate-Judge in this case was made pursuant to section 636(b), this Court offers no opinion on the propriety of referring bankruptcy appeals to a magistrate-judge for final decision pursuant to section 636(c)(1).

> defined by the common law has been carried over . . . to section 553, whose language is permissive, not mandatory. "Its application, when properly invoked before a court, rests in the discretion of that court, which exercises such discretion under the general principles of equality." 4 Collier on Bankruptcy ¶ 553.02, at 553-11 (15th ed. 1983).

Id. (citations omitted); *accord In re Bevill, Bresler & Schulman Asset Management Corp.*, 896 F.2d 54, 57 (3d Cir. 1990) (equitable right of setoff is permissive, not mandatory and cannot be invoked in a case where the general principles of setoff would not justify it).

13. Moreover, the Magistrate-Judge's Report and Recommendation correctly states the standard of review for issues that arise in determining whether the United States has a right of setoff. Findings of fact by the Bankruptcy Court may be set aside only if the findings are "clearly erroneous." *See* Bankr. Rule 8013. The Bankruptcy Court's legal conclusions are subject to plenary review. *J.P. Fyfe, Inc. of Florida v. Bradco Supply Corp.*, 891 F.2d 66, 69 (3d Cir. 1989); *Brown v. Pennsylvania State Employees Credit Union*, 851 F.2d 81, 84 (3d Cir. 1988). Bankruptcy decisions involving the court's exercise of discretion are reviewed for abuse of discretion. *See In re Vertientes, Ltd.*, 845 F.2d 57, 59 (3d Cir. 1988). Accordingly, this objection by the United States is without merit.

14. Relying on *United States ex rel. Internal Revenue Service v. Norton*, 717 F.2d 767 (3d Cir. 1983), the Bankruptcy Court held that confirmation of Continental's Plan of Reorganization vitiated the United States's setoff rights, because upon confirmation, all property of the estate vested in Continental,

free and clear of any claims or interests. In her Report and Recommendation, the Magistrate-Judge agreed with the Bankruptcy Court's conclusion. The United States objected to the Magistrate-Judge's conclusion, asserting that confirmation of the Plan of Reorganization did not affect its right to setoff the funds deposited with the Registry of the Bankruptcy Court against debts owed by Continental to the United States.

15. In *United States ex rel. Internal Revenue Service v. Norton*, 717 F.2d 767 (3d Cir. 1983), the Internal Revenue Service sought to setoff a tax refund owed to Chapter 13 debtors against the debtors' pre-petition tax debts. The debtors' plan to pay off all of their creditors completely was confirmed by the Bankruptcy Court before the Internal Revenue Service withheld the refund. *Id.* at 774. The Court of Appeals for the Third Circuit concluded that the Internal Revenue Service was bound by the confirmed plan and not entitled to a setoff, because the plan did not expressly provide them with this right. *Id.* The Court opined:

> The provisions of a confirmed Chapter 13 plan bind the debtor and each creditor, whether or not the plan provides for the claim of a particular creditor. 11 U.S.C. § 1327(a) (1979). . . . Unless the plan provides otherwise, the property of the estate vests in the debtor upon confirmation and comes free and clear of any claim or interest of any creditor provided for by the plan. . . .
>
> Here, the Bankruptcy Court gave the IRS notice and an opportunity to have its objections to the proposed plan heard, an opportunity the IRS

> failed to take. Upon confirmation, the IRS became bound to that plan and to the payment schedule that would satisfy its claim in full.

Id. The court concluded that to permit the Internal Revenue Service to retain the refund as a setoff after confirmation of a plan that did not provide them with this right "would seriously compromise the powers of the Bankruptcy Court, the capacity of the debtors' to rehabilitate, and the equitable distribution that the Bankruptcy Code is designed to foster." *Id.*

16. The only distinction between the facts of *Norton* and this case is that in *Norton* the bankruptcy petition was filed under Chapter 13, whereas in this case the petition was filed under Chapter 11. Notwithstanding this distinction, both the Bankruptcy Court and the Magistrate-Judge were correct in concluding that this case is controlled by *Norton*. The provisions governing the effect of confirmation in Chapter 11 and Chapter 13 proceedings, sections 1141[3]

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[3] Section 1141 provides:

> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor . . . and any creditor, . . . whether or not the claim or interest of such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.
>
> (b) Except as otherwise provided in the plan or in the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
>
> (c) Except as otherwise provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors. . . .

and 1327[4] of the Bankruptcy Code respectively, are virtually identical. Both provisions bind the debtor and all creditors. *See* 11 U.S.C. §§ 1141(d)(1), 1327(a); *see also Norton*, 717 F.2d at 774. Under both provisions, unless the plan provides otherwise, the property of the estate vests in the debtor upon confirmation and comes free and clear of any claim or interest of any creditor provided for by the plan. *See* 11 U.S.C. §§ 1141(1), 1327(a); *see also Norton*, 717 F.2d at 774. Thus, the same considerations found to be dispositive by the Third Circuit in *Norton* are equally applicable here.

17. Accordingly, pursuant to *Norton*, a creditor's right to setoff is extinguished by a confirmed Chapter 11 plan, unless the plan explicitly preserves it. In the present case, Continental's plan did not provide the United States or any of its agencies with the right to setoff. In fact, not only does Continental's Plan fail to

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Section 1141(d)(2) and (d)(3) are irrelevant for purposes of this issue.

[4] Section 1327 provides:

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

provide the United States with setoff rights, it expressly prohibits the United States from setting off its claims without Continental's approval. Section 14.8 of the Plan entitled "Setoffs" provides: "Each Debtor . . . may, *but shall not be required to*, set off or recoup against any Claim . . ., claims of any nature whatsoever which such Debtor . . . may have against the holder of such Claim to the extent that such claim may be set off or recoup under applicable law. . . ." *See* [Docket Item 10, vol. II, Exh. 9, at 112] (emphasis added). Therefore, the United States does not have the right to setoff the funds deposited in the Registry of the Bankruptcy Court for the District of Delaware against debts owed by Continental to the United States or its agencies.

18. Because the conclusion that the United States's setoff rights, if any, were extinguished upon confirmation of Continental's Plan of Reorganization is dispositive of the issue presented here, the Court will not address any of the additional rulings of the bankruptcy court.

NOW, THEREFORE, IT IS ORDERED that:

The Orders of the Bankruptcy Court are affirmed.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 93-485-LON

CONTINENTAL AIRLINES, DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

CONTINENTAL AIRLINES, APPELLEE

THOMAS E. ROSS, TRUSTEE

MAGISTRATE'S REPORT AND RECOMMENDATION

Dated: September 15, 1994

Wilmington, Delaware

TROSTLE, U.S. Magistrate-Judge

This matter comes before the Court on appeal from an Order of the United States Bankruptcy Court for the District of Delaware denying the United States' motion requesting the return of monies deposited with the Registry of the Court as a setoff against monies owed by Continental Airlines, Inc. ("Continental") to the United States and granting Continental's cross-motion for disbursement of the funds (D.I.

14, A-168, A-174); *In re Continental*, case nos. 90-932 - 90-984, Orders (September 30, 1993) (Balick, J.). In reviewing decisions of the Bankruptcy Court, the District Court sits as a Court of Appeals. 28 U.S.C. §§158(a), 1334.

FACTS AND PROCEEDINGS

Background Facts

The material facts in this case are not in dispute. On December 3, 1990, Continental and its affiliates (also referred to as "Debtors") filed petitions for reorganization under Chapter 11 of the Bankruptcy Code. On April 16, 1993, the Bankruptcy Court entered an Order confirming the Debtors' Revised Second Amended Joint Plan of Reorganization. From December 3, 1992 to April 16, 1993, ten agencies of the United States (also referred to as "Government") filed separate proofs of claim against Continental (D.I. 13 at 4). Four agencies used Continental's form, three used their own form, two used Bankruptcy Form 19 and one used Bankruptcy Form 10.

The four agencies using Continental's form were:

> (1) **United States Custom Service**, amended proof of claim filed on September 23, 1991 for $5,420,830; (2) **Equal Opportunity Commission**, amended proof of claim filed on September 23, 1991 for $3,500.00; (3) **Immigration and Naturalization Service**, amended proof of claim filed on September 16, 1992 for $5,859,851.52; and (4) **Department of Labor**, proof of claim filed on September 17, 1991 for $42,000.00.

Paragraph 7 of Continental's form provided an option for setoff rights, stating:

> this claim ( ) is not subject to any setoff or counterclaim of ( ) is subject to any setoff or counterclaim as follows:_____.

However, all four agencies left this paragraph blank (D.I. 13 at 4-5, D.I. 16 at 16).

The three agencies using their own proof of claim form were:

> (1) **Department of Agriculture ("DOA")**, proof of claim filed on February 19, 1991 for $94,266.71; (2) **Department of the Air Force**, amended proof of claim filed on October 27, 1991 for $155,572.89; and (3) **Federal Aviation Administration ("FAA").**

Paragraph 8 of the DOA's form provided

> the **filing of this claim is not to be construed . . . as a waiver of any . . . right of action or setoff** . . . that the United States or any agency . . . may have against the bankrupt, the receiver, the trustee, or any person (Emphasis added).

(D.I. 13 at 5). However, the Department of Air Force's form specifically provided "[t]here **are no setoffs or counterclaims to this said debt**" (D.I. 13 at 5). The FAA used a combination of Continental's form, its own form and the Settlement Agreement. Continental and the FAA negotiated several months with regard to the FAA's claim. The settlement reached on September 18, 1991 provided in part:

> Continental proposes that with respect to the FAA's civil penalty matter, [sic] Continental agrees to allow the FAA a general unsecured claim in the amount of $3,405,700.00 and to

> amend its schedules filed in the bankruptcy court to reflect same. That sum will be fixed as a an allowed claim and will affect the comprised resolution of all civil penalty matters involving FAA and Continental Airlines and all of the affiliated companies described above.

(D.I. 13 at 5-6). The bankruptcy court approved the Settlement Agreement on November 26, 1991. Pursuant to a court ordered extension, the FAA did not file its proof of claim until one day after execution of the Settlement Agreement, on November 27, 1991. The Settlement said nothing about setoff. Although the FAA did not check paragraph 7 of Continental's form regarding setoff, it stated "see Rider A attached hereto." Paragraph 9 and 10 of Rider A provided:

> 9. The amount of all payments on this claim has been credited and deducted for the purpose of making this Proof of Claim.
>
> 10. The **United States reserves its right to perfect any and all appropriate setoff.** (Emphasis added).

(D.I. 13 at 6-7).

> The two agencies using Bankruptcy Form 19 were:
>
> (1) **Peace Corps**, proof of claim filed on September 10, 1991 for $934.90; (2) **United States Postal Service**, proof of claim filed on January 22, 1991 for $42,275.00.

(D.I. 13 at 7).

The Drug Enforcement Administration filed a proof of claim using Bankruptcy Form 10 on August 23,

1991 for $837.50 (D.I. 13 at 7). Paragraph 6 of Form 10 provided:

> CREDITS AND SETOFFS: the amount of all payments on this claim has been credited or deducted for the purpose of making this proof of claim. In filing this claim, claimant has deducted all amounts that claimant owes to debtor.

(D.I. 13 at 7).

In prior litigation, Continental, along with other airlines, commenced an administrative proceeding before the Comptroller General challenging the Government Service Administration's ("GSA") policy and practice regarding Government travel. The Comptroller General ruled that GSA had wrongfully withheld funds from the airlines. As a result of GSA's failure to abide by the ruling, the airlines filed suit in the United States District Court for the District of Columbia. *Alaska Airlines, Inc., et al. v. Richard Austin, et al.*, 801 F.Supp. 760 (D.D.C. 1992) (Sporkin, J.), *aff'd. in part, rev'd. in part on other grounds*, 8 F.3d 791 (Fed.Cir. 1993). On August 11, 1992,[1] the District Court ruled in the airlines' favor. Pursuant to the Federal Circuit's Order, the Government deposited approximately $4,763,219.60 in the Registry of the Bankruptcy Court for the benefit of Continental (also referred to as "*Alaska Airlines* Fund").

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[1] Of the eleven agencies (including GSA) involved in the litigation, only two filed proofs of claim after the August 11, 1992 *Alaska Airlines* decision. Of those two, one proof of claim explicitly asserted a right to setoff of the *Alaska Airlines* debt (GSA's proof of claim), and the other made no assertion claiming setoff against Continental (INS' proof of claim).

In addition to the ten agencies, GSA filed an amended proof of claim on May 28, 1993 for $517,042.09 and specifically asserted a right of setoff against the *Alaska Airlines* debts.

Continental submitted a Revised Second Amended Joint Plan of Reorganization ("Plan") to its creditors for a vote in January 1993. The IRS, DOA and FAA objected to the Plan. The IRS' objection only involved the priority of claims, scope of releases as to the officers and directors of the debtor companies and rights to offset tax claims owed by Continental, specifically against tax refunds. The DOA objected to the enforceability of the officer and director releases. These objections were resolved by stipulation. The FAA objected on the grounds that the provisions regarding satisfaction of the FAA's unsecured claims with stock in the reorganization debtor were inappropriate, FAA did not receive the same treatment as System One Holdings, Inc. (an affiliate of Continental), and officer and director releases rendered the Plan unconfirmable. These objections were also resolved by stipulation. Neither the IRS, DOA nor FAA's objections involved the right of setoff against the *Alaskan Airlines* debts.

On April 16, 1993, after notice and a hearing, the Bankruptcy Court confirmed the Plan. Thereafter, on May 28, 1993, the Government moved in the Bankruptcy Court for an Order offsetting the $4,763,219.60 deposited in the Registry as a setoff against monies owed by Continental to the United States. Continental opposed the motion and cross-motioned for disbursement of the funds. After a hearing on August 17, 1993, Judge Balick denied the United States' motion to allow offset and on September 14, 1993,

granted Continental's cross-motion for a disbursement of funds.[2] The United States appealed the two rulings to this Court. On October 19, 1993, the Court granted the United States a stay pending appeal of the Bankruptcy Court Order granting Continental's cross-motion for disbursement.

On appeal, the United States asserts that the Bankruptcy Court erred in denying its right of setoff. The Bankruptcy Court essentially held that (1) the agencies of the United States did not have mutuality for setoff purposes since each agency filed a separate proof of claim, and therefore, was a separate creditor under the Bankruptcy Code; (2) confirmation of Continental's plan of reorganization discharged Continental from its prepetition debts, thereby denying the United States a subsequent right of setoff; (3) FAA's claim was not available for setoff since it involved a postpetition settlement; (4) the United States waived its right of setoff by filing proofs of claims which did not assert a right of setoff; (5) the United States was estopped from asserting its right to setoff the FAA claim because of its conduct in negotiations leading up to the confirmation of Continental's plan of reorganization (D.I. 13, 14 at A-168). This Court shall address each issue in turn.

Basis of Appellate Jurisdiction

Section 158(a) of Title 28 of the United States Code provides that:

> The district courts of the United States shall have jurisdiction to hear appeals from final

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[2] The orders embodying these rulings were issued on September 30, 1993 (D.I. 14, A-168, A-174).

> judgements, orders and decrees, and with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title . . .

28 U.S.C. 158(a).

Standard of Review

The proper standard to be applied by a district court reviewing the rulings of a bankruptcy court turns on the nature of the issues presented on appeal. Factual determinations of the bankruptcy court are entitled to deference and are not reversed unless found to be clearly erroneous. Bankruptcy Rule 8013; *In re Morrisey*, 717 F.2d 100, 104 (3d Cir. 1983). Legal conclusions of the bankruptcy court are subject to plenary review by the district court and are considered *de novo* on appeal. *Brown v. Pennsylvania State Employees Credit Union*, 851 F.2d 81, 84 (3d Cir. 1988). Bankruptcy decisions involving the court's exercise of discretion are reviewed for abuse of discretion. *In Re Trans World Airlines, Inc.*, 1993 WL 559245, *6 (D.Del., June 22, 1993) (Robinson, J.) (*citing In Re Vertientes, Ltd.*, 845 F.2d 57, 58-59 (3d Cir. 1988)); *In Re Continental Airlines*, 150 B.R. 334, 336 (D.Del. 1993) (Robinson, J.). Abuse of discretion will be found if the court's ruling was "founded on an error of law or clearly erroneous view of the facts or misapplication of law to the facts." *In Re Gioioso*, 979 F.2d 956, 959 (3d Cir. 1992). Further, a judge's discretion will be found to have been abused

> when the judicial action is arbitrary, fanciful or unreasonable, which is another way of saying that discretion is abused only where no reason-

> able man would take the view adopted by the trial court. If reasonable minds could differ as to the propriety of the action taken by the trial court, then it cannot be said that the trial court abused its discretion.

In Re Blackwell, 162 B.R. 117, 119 (E.D. Pa. 1993) (*citing In Re Shariyf*, 68 B.R. 604, 606-07 (E.D. Pa. 1986)). The application of 11 U.S.C. §553 is solely within the discretion of the court, under the general principles of equality. *United States v. Norton*, 717 F.2d 767, 772 (3d Cir. 1983), *superseded by statute on other grounds*. Since the Bankruptcy Court's decision denying setoff was within its discretion, the decision should be reviewed for abuse of discretion.[3] The Court's legal determination of mutuality under 11 U.S.C. §553 is subject to plenary review.

DISCUSSION

Right of Setoff

Setoff rights in bankruptcy are governed by 11 U.S.C. §553, which provides in relevant part:

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[3] As stated, abuse of discretion is the standard for reviewing equitable decisions of the bankruptcy court. The bankruptcy court's equity powers are derived from §105(a) of the Bankruptcy Code, which provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this Title. No provisions of this Title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abusive process.

11 U.S.C. §105(a).

> (a) Except as otherwise provided in this Section and in Sections 362 and 363 of this Title, this Title does not effect any right of a creditor to **offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case**. . . . (Emphasis added).

11 U.S.C. §553(a). Section 553 does not create a right of setoff, it merely preserves in Bankruptcy law the right of setoff available at common law. *Matter of Bevill, Bresler & Schulman Asset Mgmt*, 896 F.2d 54, 57 (3d Cir. 1990) (*citing United States v. Norton*, 717 F.2d at 772).[4] This right of setoff is grounded in equity and fairness, and is a defense to a claim brought by a debtor against a creditor. *United States v. Norton*, 717 F.2d at 772; *In Re DeLaurentis Entertainment, Inc.*, 963 F.2d 1269, 1277 (9th Cir.), *cert. denied*, — U.S. —, 113 S.Ct. 330 (1992). *In Re G.S. Omni Corp.*, 835 F.3d 1317, 1318 (10th Cir. 1987). This equitable right of setoff depends on the existence of mutual debts and claims between the creditor and debtor. *Matter of Bevill*, 896 F.2d at 57. The common law doctrine of setoff essentially grants a creditor the right "'to offset a mutual debt owing by such creditor to the debtor' so long as both debts arose before commencement of the bankruptcy action and are indeed mutual." *In Re Davidovich*, 901 F.2d 1533, 1537 (10th Cir. 1990) (*quoting* 11 U.S.C. §553(a)).

A creditor carries the burden of proving that it has a right of setoff in bankruptcy. *In Re Ionosphere Clubs, Inc.*, 164 B.R. 839, 841 (Bankr. S.D.N.Y. 1994)

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[4] Therefore, Section 553 cannot be considered an "independent source of law governing setoff," but a "legislative attempt" to preserve the common law right of setoff. *United States v. Norton*, 717 F.2d at 772; *Matter of Bevill*, 896 F.2d at 57.

(*citing First National Bank of Louisville v. Hurricane Elkhorn Coal Corp.*, 763 F.2d 188, 190 (6th Cir. 1985)). Although the right of setoff exists outside of bankruptcy, a creditor must satisfy the following conditions pursuant to §553(a):

> 1. A debt exists from the creditor to the debtor and that debt arose prior to the commencement of the bankruptcy case.
>
> 2. The creditor has a claim against the debtor which arose prior to the commencement of the bankruptcy case.
>
> 3. The debt and the claim are mutual obligations.

Braniff Airways, Inc. v. Exxon Co., U.S.A., 814 F.2d 1030, 1035 (5th Cir. 1987) (*quoting In Re Nickerson & Nickerson*, 62 B.R. 83, 85 (Bankr. D. Neb. 1986)). However, even if these three technical requirements are satisfied, the right of setoff must still be scrutinized in light of the Bankruptcy Code's goals and objectives.[5]

Requirement of a "Debt" Under §553 of the Bankruptcy Code

The right to setoff depends on the mutuality of prepetition "debts" owed to and owed by a creditor. *Ionosphere Clubs*, 164 B.R. at 841;[6] *In Re Drexel*

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[5] Although the application of 11 U.S.C. §553 is permissive, not mandatory, and within the discretion of the court, it cannot be invoked where the general principles of setoff would not justify its application. *Matter of Bevill*, 896 F.2d at 57.

[6] The *Alaska Airlines* debt was also in dispute in *Ionosphere Clubs*, which involved the same Fund and many of the parties present in this case. As in the instant case, the Government in

Burnham Lambert Group, Inc., 113 B.R. 830, 839 (Bankr. S.D.N.Y. 1990). In the *Alaska Airlines* litigation, it was made abundantly clear by the District Court and Federal Circuit that the Fund belonged to the Debtors. The District Court specifically stated:

> Both the GAO and the Court have found that the Government arbitrarily and without justification has withheld from the Plaintiffs money clearly belonging to them. In essence, the **Government improperly has taken Plaintiffs' property from them without any legal basis for doing so.** (Emphasis added).

Ionosphere Clubs attempted to set off the *Alaska Airlines* Fund, an amount owed by GSA, against claims of the GSA and various other federal agencies. GSA, along with the other agencies, moved for relief from the automatic stay to set off funds owed by the Government to Eastern Air Lines for prepetition transactions against the prepetition debts owed by Eastern. The Bankruptcy Court for the Southern District of New York held that (1) the Government had no right to utilize the monies deposited with the registry of the court (*Alaska Airlines* Fund) to offset its debts because the Fund was not a "debt," but property of the debtor's estate; and (2) there was not mutuality of obligation between the governmental agencies for purposes of setoff. *Ionosphere Clubs*, 164 B.R. at 841-42.

The Trustee for Eastern Air Lines had also attempted to bind the Government to the Delaware Bankruptcy Court decisions in this case and in *In Re Trans World Airlines, Inc.*, No. 92-115 (Bankr. D. Del., September 30, 1993) (Balick, J.), which held that the United States could not setoff debts and obligations of different agencies. However, pursuant to the Supreme Court decision in *United States v. Mendoza*, 464 U.S. 154 (1984), offensive collateral estoppel did not apply to the Government. *Id.* at 842, n. 1.

Ionosphere Clubs, 164 B.R. at 841 (*quoting Alaska Airlines v. Austin*, No. Civ. 90-2879, 1992 WL 464711, at *2 (D.D.C. 1992)). On appeal, the Federal Circuit referred to the District Court's decision stating:

> The court also declared that because GSA holds funds withheld illegally, funds rightfully belonging to the airlines, to provide complete relief, and based on its conclusion that under the statutes the government had no right to withhold money, that money had to be returned.

Alaska Airlines, Inc. v. Johnson, 8 F.3d 791 (Fed. Cir. 1993). As concluded in *Ionosphere Clubs*, the *Alaska Airlines* Fund is "clearly **owned by**, as opposed to **owed** to the Debtor," and thus the Government has no right to utilize this Fund to offset its debts.

The Third Circuit analyzed the requirement of mutual "debts" under §553 in *Matter of Bevill*, 896 F.2d at 57-58. In *Bevill*, a creditor withheld income payments on government bonds and mortgage instruments from the debtor, and sought to avoid turning over these funds based on a claimed right of setoff against amounts owed to the creditor by the debtor. The Court determined that the Treasury Bonds, the coupon interest and the GNMA principal and interest were the property of the debtor, and the creditor was merely a trustee. Since the debtor was the "owner" of the funds, the creditor had no right to retain the payments, and therefore, there was no "debt" to be set off. *Id.* at 58. Applying this logic to the present case, the *Alaska Airlines* Fund cannot be considered a debt owed to Continental. It is undisputed that the *Alaska Airlines* Fund was money owned by, not owed to,

Continental. As a result, the Government should not be allowed to utilize the Fund to setoff its debts.

Mutuality of Obligation

Even if the *Alaska Airlines* Fund is considered a debt owed to Continental, the Government would still not be entitled to a setoff due to the lack of mutuality between the government agencies. As provided in §553(a) of the Bankruptcy Code, a prerequisite to the right of setoff depends on mutuality of obligation between the creditor and debtor, in other words, where the bankrupt and creditor owe a debt to each other. *Matter of Bevill*, 896 F.2d at 57. Therefore, in order to satisfy the mutuality requirement, all of the federal agencies together must be considered a single entity and an individual creditor for purposes of setoff. In this case, Continental asserts that the eleven agencies involved cannot be considered one entity for setoff purposes, and therefore not mutual. Judge Balick found that the agencies were separate creditors and not mutual for purposes of setoff (D.I. 14 at A-169, relying on the decision in *In Re Hancock*, 137 B.R. 835, 846-47 (Bankr. N.D. Ok. 1992)). In response, the United States asserts that Judge Balick erred in following the reasoning of *Hancock*, since it was clearly a minority opinion and "the single case not reversed on appeal which holds that agencies of the United States are not one entity for setoff purposes" (D.I. 13 at 14, Appellant's Br. [7]).

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[7] The Government further asserts that regardless of whether *Hancock* was correctly decided, the court's rationale is inapplicable to this case because the transfer in *Hancock* was made prepetition and the court's concern was whether the transfer violated the policy of equality of distribution among creditors (D.I. 13 at 24, n. 7). In this case, Continental's Plan

In examining the decisions in *Ionosphere Clubs*, 164 B.R. at 842-843[8] and *In Re Lakeside Community Hosp., Inc.*, 151 B.R. 887, 892-93 (N.D. Ill. 1993), as well as a leading bankruptcy treatise, William L. Norton, Jr., 2 *Norton Law and Bankruptcy Practice* §33.05 at Supp. p. 11 (July 1993 Interim Supp.), §63:6 (January 1994) (the minority position cases holding that mutuality is lacking in such circumstances are based on well reasoned opinions),[9] there is at least one other case which has concurred with the reasoning in *Hancock*, and which has not been reversed.[10] In *Iono-*

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was confirmed and distribution to the creditors fixed. Although the *Hancock* court discussed distribution to third parties, equality among creditors and preferential transfers, it clearly separated those issues from its analysis of the mutuality requirement for setoff purposes. After holding that the transfer was not a setoff but a preferential transfer, the court stated, "[a]lternatively, even if this transaction were of the general type which might be called 'setoff,' the question remains whether this transaction satisfies the usual conditions of setoff, and in particular the requirement of mutuality of obligations." *Hancock*, 137 B.R. at 845.

[8] The Court understands that this decision was rendered in February 1994, approximately three months after the parties in the present case briefed the issue, and therefore could not have been within the knowledge of the parties during briefing.

[9] Section 33.05 at Supp. p. 11 provides that "agencies within the same government" are "separate entities for purposes of mutuality under § 553."

[10] It should be noted that in contrast with the cases relied upon by the Government, the more recent authorities specifically addressing the issue of interagency setoff, including the decisions in *Hancock*, *Lakeside*, *Ionosphere*, as well as *Norton Law and Bankruptcy Practice*, §33.05, have concluded that agencies within the same government lack mutuality for purposes of setoff under § 553. *Cherry Cotton Mills* cannot be considered persuasive because it did not address the strict re-

sphere, the court recognized a "divergence of authority" regarding whether mutuality exists among governmental agencies for the purpose of setoff. Acknowledging that a number of courts had found that debts and claims incurred by different governmental agencies to be mutual, the court stressed that none of these cases contained an analysis of the issue relied upon the Supreme Court decision in *Cherry Cotton Mills, Inc. v. United States*, 327 U.S. 536 (1946). Although *Cherry Cotton* could be considered analogous to the facts in this case and *Ionosphere Clubs*, it was found distinguishable in that there were no other unsecured creditors and its conclusions were limited to the facts of the case or other similar nonbankruptcy matters.[11] *Ionosphere Clubs*, 164 B.R. at 842.

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quirement of mutuality under §553, and the fact that a right of setoff exists outside bankruptcy does not automatically mean that the nonbankruptcy right complies with the mutuality requirement of §553. *See WJM, Inc. v. Massachusetts Dep't of Pub. Welfare*, 840 F.2d 996 (1st Cir. 1988). Further, in *Borsage v. United States Dep't of Educ.*, 5 F.3d 1414, 1419 n. 7 (11th Cir. 1993), the court addressed the issue of setoffs of debts owed and owing to different federal agencies outside of bankruptcy. In finding mutuality of obligations, the Eleventh Circuit noted that cases involving setoff in a bankruptcy context were inapposite in the nonbankruptcy context, since "the federal law of bankruptcy presents different and unique considerations, as payments made by one government agency to another during a bankruptcy proceeding may operate to the detriment of other creditors." *Id.* (*citing Hancock*, 137 B.R. 835 and *Lakeside*, 151 B.R. 887).

[11] In *Cherry Cotton Mills*, the Government sought to setoff a tax refund due a petitioner under the Agriculture Adjustment Act against a loan the petitioner owed to the Reconstruction Finance Corporation. *Cherry Cotton Mills*, 327 U.S. at 537.

As explained, §553 permits setoff by a "creditor" of a mutual debt owed by such creditor to the debtor. Section 101 of the Bankruptcy Code defines "creditor" as an "entity that has a claim against the debtor." 11 U.S.C. §101(10). An entity is understood to include a "governmental unit," 11 U.S.C. §101(15), and "governmental unit is defined as the "United States; State; . . . [or] department, agency, or instrumentality of the United States." 11 U.S.C. §101(27). In *Ionosphere*, the court applied the general rule of construction that each word in a statute should be given effect, and found the holding in *Lakeside* to be persuasive that "Congress intended that [governmental] units be treated as distinguishable and therefore not the same creditor within the provisions of the statute." *Ionosphere Clubs*, 164 B.R. at 842-43 (*quoting Lakeside*, 151 B.R. at 891); *Hancock*, 137 B.R. at 846. Relying on both the holding in *Hancock* and the language of the Bankruptcy Code, Judge Balick similarly determined that the governmental agencies were separate entities for the purposes of mutuality under §553. In reaching her decision, Judge Balick clearly relied on the "plain language" of §553 in conjunction with the definitional section 101 of the Bankruptcy Code.

In this instance, the federal agencies involved have distinct administrative structures, separate budgets and staffs, possess different rights, powers and privileges and have separate relationships with Continental. Moreover, each agency filed a separate proof of claim, on different forms, with some agencies explicitly waiving setoff rights and others reserving such rights. Although the Government claims that the agencies filed separate proofs of claims merely for

"administrative convenience" (D.I. 13 at 21-22), it fails to explain why some reserved a right of setoff, others waived the right and some did not assert a right either way. These agencies were clearly not acting as a joint body or a single governmental unit. In reviewing these facts, as well as the decisions in other jurisdictions, Judge Balick's finding that the requisite mutuality of obligations and claims did not exist so as to grant the Government the right to set off the *Alaska Airlines* Fund against debts owed by Continental is not an error of law.[12]

Confirmation of Continental's Plan

The Bankruptcy Court also cited alternative grounds for denying the United States' motion. Relying on *Norton*, the Court concluded that upon confirmation of Continental's Plan of Reorganization on April 16, 1993, all property of the estate vested in Continental, free of any claims or interests (D.I. 14 at A-170). Judge Balick specifically stated:

> Although *Norton* dealt with §1327(c) of the Bankruptcy Code, the **language of §1141(c) applicable to this case is identical,**[13] **and**

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[12] Although the Government suggests that Judge Balick's findings regarding mutuality have limited bases in law, its argument appears to rest more on an abuse of discretion standard.

[13] 11 U.S.C. §1327(c) provides:

> Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

11 U.S.C. §1141(c) provides:

> **Continental became vested in its property free of any claim of offset** by the Government. Whether they participate or not, all creditors, including the Government, are bound by the terms of Continental's confirmed Plan, and it is an **essential part of completing a bankruptcy proceeding, whether Chapter 11 or Chapter 13, that there be finality.** (Emphasis added).

(D.I. 14 at A-170). As the Bankruptcy Court reasoned, the essence of §§1141 and 1327 is to achieve finality and certainty. Judge Balick's reliance on *Norton* appears to be sound. Further, in *Norton*, the court emphasized the right to object to the confirmation of a plan by a party in interest. Although *Norton* dealt with a confirmed plan under Chapter 13 instead of Chapter 11, the same logic can be applied in both contexts.

The United States places heavy reliance on *DeLaurentis Entertainment*, 963 F.2d 1269. In *DeLaurentis*, the Ninth Circuit held that §553 took precedence over §1141. *Id.* at 1276-77. The court stated that if §1141 was to take precedence over §553, setoffs would only be allowed if written into a plan of reorganization, and §553 would essentially be meaningless. *Id.* at 1277. The Third Circuit's holding in *Norton*, however, is controlling and Judge Balick's application of that holding to this case (involving the confirmation of a Chapter 11 Plan) should not be con-

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Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and all general partners in the debtor.

sidered an abuse of discretion. Moreover, as previously concluded, the *Alaska Airlines* Fund cannot be considered a "debt" owed to Continental since it was determined to be property of Continental's estate by the District Court of the District of Columbia and Federal Circuit. Because the Fund was "owned by" Continental, it should not be used to offset its debts.

Waiver/Post-Petition Obligations

The Bankruptcy Court further held that in failing to indicate or describe any right of setoff, the various agencies affirmatively waived any right to offset and therefore, pursuant to the settlement agreement between Continental and the FAA, Continental's obligation arose post-petition and was not mutual to the pre-petition obligation owed by GSA to Continental. It was within Judge Balick's discretion to conclude that a valid waiver existed. *In Re Metropolitan Intern., Inc.*, 616 F.2d 83, 86 (3d Cir. 1980) (*citing Linda Coal and Supply Co. v. Tasa Coal*, 204 A.2d 451 (Pa. Supr. 1964)). The language of the proof of claim forms is clear. By failing to express a right of setoff or by waiving such a right, the agencies should be considered to have waived any right to setoff. *In Re Mauch Chunck Brewing Co.*, 131 F.2d 48, 49 (3d Cir. 1942) (failing to assert the right of setoff or exhibiting conduct which is inconsistent with a subsequent claim of setoff shall be considered a waiver of the right). Moreover, the basis of the Bankruptcy Court's decision was rational, founded on sound legal principle, and therefore, should not be considered either legally erroneous or an abuse of discretion.

Finally, the Bankruptcy Court determined that the FAA's claims against Continental arose post-petition, due to the settlement agreement between the FAA

and Continental which converted the claims from pre-petition to post-petition. As a result, there was no longer any mutuality with regard to the pre-petition obligation owed by GSA to Continental. Since it has previously been decided that the FAA lacked the mutuality necessary to offset under §553, the issue of whether Continental's obligations arose post-petition or pre-petition need not be addressed.

CONCLUSION

For the reasons set forth herein, the Bankruptcy Court did not abuse its discretion in denying the United States' motion for setoff. Therefore, I recommend that the Bankruptcy Court's decision is AFFIRMED.

An Order consistent with this Report and Recommendation shall follow.

APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

Case Nos. 90-932 to 90-984

IN RE: CONTINENTAL AIRLINES, INC., ET AL., DEBTORS

[Filed: September 30, 1993]

ORDER ON MOTION OF THE UNITED STATES FOR AN ORDER DIRECTING THE RETURN OF MONIES DEPOSITED WITH THE REGISTRY OF THE COURT

THIS MATTER comes on before the Court on the Motion of the United States for an Order Directing the Return of Monies Deposited With the Registry of the Court, and the Cross-Motion of Continental Airlines, Inc. ("Continental") for Disbursement of those funds to Continental. This matter having been briefed, and the Court having heard oral argument on August 17, 1993 and now being fully advised in the premises, hereby finds as follows:

The material facts in this case are not in dispute. At [a] hearing on August 17, 1993, the Court accepted the written chronology of events tendered by the United States (attached hereto), to which Continental stipulated. Continental noted two additional facts not disputed by the Government: first, that on September 10, 1990, the General Accounting Office ("GAO") handed down its decision in the administrative action brought by various airlines against the General

Services Administration ("GSA"), which decision upheld the position of the airlines; and second, that the GAO reaffirmed that decision on September 23, 1991. The proofs of claim, pleadings, and settlement agreements referenced in the briefs and argument are all matters of record with this Court or other courts, all of which this Court takes notice.

It is not disputed by the Government that a prerequisite to any right of offset that it may assert is mutuality of obligation. In this case, the obligation which the Government seeks to offset results from the judgment entered by the United States District Court for the District of Columbia in the case of *Alaska Airlines, et al. v. Richard Austin, et al.*, Case No. 90-2879 (Judge Sporkin), reported at 801 F.Supp. 760 (D.D.C. 1992), in which Richard G. Austin (head of the GSA), the GSA and the United States are Defendants. It is also undisputed that the GSA filed a proof of claim indicating a balance owed to Continental. Thus, the claims which the Government seeks to offset are all claims of other agencies, *e.g.* the United States Customs Service, the Immigration and Naturalization Service, the U.S. Postal Service, etc. Each of these entities filed separate proofs of claim. The Court elects to follow the reasoning of *In re Hancock*, 137 B.R. 835 at pp. 846, 847 (Bankr. D. Utah 1992), and holds that these agencies are separate creditors for purposes of 11 U.S.C. § 553, and are therefore not the same parties for establishing mutuality for purposes of setoff. *See also In re Lakeside Community Hospital, Inc.*, 151 B.R. 887 (N.D. Ill. 1993) (finding that separate state agencies are separate creditors under similar circumstances). Accordingly, the only creditor with the mutuality of obligation to be considered

for purposes of offset is the GSA, which, as noted, filed a proof of claim which indicated a balance owed *to* Continental. The Government's motion must therefore be denied.

There are other alternative and equally sufficient grounds for denial of the Government's motion. The holding in *United States v. Norton*, 717 F.2d 767 (3d Cir. 1983) also is controlling here. In *Norton*, the IRS lost its right to offset because the confirmed plan, which did not provide such a right, vested all property in the debtors, free and clear of all claims or interests, and the IRS had not objected to confirmation. Similarly, upon confirmation of Continental's Revised Second Amended Joint Plan of Reorganization on April 16, 1993, all property of the estate vested in the Debtors, free and clear of any claims or interest. Although *Norton* dealt with § 1327(c) of the Bankruptcy Code, the language of § 1141(c) applicable to this case is identical, and Continental became vested in its property free of any claim of offset by the Government. Whether they participate or not, all creditors including the Government, are bound by the terms of Continental's confirmed Plan, and it is an essential part of completing a bankruptcy proceeding, whether Chapter 11 or Chapter 13, that there be finality.

Additionally, the claim of the Federal Aviation Administration ("FAA") was disputed, and a settlement with respect to that claim was reached in which the FAA agreed that its claim was to be treated as a general unsecured claim in the amount of $3,405,700. This settlement was a compromise, as all or a portion of the FAA's claim might otherwise have been subordinated as a penalty. Further, the claim was treated

as a general unsecured claim for purposes of voting on the Plan. Finally, it was treated as a general unsecured claim by the FAA in its objection to confirmation of the Plan, which resulted in a modification of the Plan concerning officer and director releases. Had the FAA asserted then that it was fully secured by its purported offset right, as it does now, it may not have had standing to object to the releases. Therefore, the Government is estopped from asserting it now has a right of setoff, not only by the specific terms of the FAA settlement, but also by its subsequent actions in this case.

Similarly, the proofs of claim filed by the various agencies failed to indicate or described any right of setoff. As such, these agencies determined to vote on the Plan and participate in these proceedings as general unsecured creditors. The proofs of claim all require a statement regarding whether the creditor claims a right to offset. In all but one instance, the creditor agencies stated that their claims were not subject to setoff. In the one exception, the proof of claim did not identify the setoff, but merely stated that any right to setoff would be preserved. These statements in the proofs of claim constitute affirmative waivers of any right to offset.

Finally, to the extent any of such pre-petition claims have been settled by agreement reached post-petition, for example, the claim of the FAA, the obligation of Continental now arises post-petition under the settlement agreement. *See Cooper-Jarrett, Inc. v. Central Transport, Inc.*, 726 F.2d 93 (3d Cir. 1984). With regard to such claims, there is no longer any mutuality with regard to the pre-petition obligation owed by GSA to Continental.

In light of the above, the Court does not reach any other arguments made by Continental in opposition to the Government's Motion.

With regard to Continental's Cross-Motion for Disbursement of Funds to Debtors, the Court withholds its ruling until hearing on September 14, 1993. In the meantime, the Courts requests the Government to inform it of the status of this issue in the cases of *Eastern Airlines, Inc.* and *Pan Am.*

By agreement of the parties and by ruling of this Court, this Order shall not be deemed entered, and therefore not final for purposes of appeal, until the court also rules on Continental's Cross-Motion for Disbursement of Funds.

DATED this 30th day of September, 1993.

UNITED STATES BANKRUPTCY COURT

/s/ HELEN S. BALICK
HELEN S. BALICK
United States
Bankruptcy Judge

Facts

Dec 3, 1990	Continental et al file petitions	
Jan 22, 1991 -	Postal Service	$ 42,275.00
Feb 19, 1991 -	Agriculture	94,266.71
Mar 15, 1991 -	Air Force	31,394.12
Aug 01, 1991 -	EEOC	unknown
Aug 23, 1991 -	DEA	837.50
Sep 10, 1991 -	Peace Corps	934.90
Sep 12, 1991 -	GSA	(585,448.20)
Sep 12, 1991 -	INS	450,267.27
Sep 17, 1991 -	Labor	42,000.00
Sep 23, 1991 -	Customs	unknown
Sep 23, 1991 -	EEOC amended	3,500.00
Sep 27, 1991	**Bar Date**	
Oct 27, 1991 -	Air Force amended	155,572.89
Nov 26, 1991	Bankruptcy Court approves settlement with the FAA	
Nov 27, 1991 -	FAA 3,405,700.00	
Aug 12, 1992	District Court issues first order in Alaska Airlines	
Aug 13, 1992 -	Customs amended	5,420,830.00
Dec 16, 1992 -	INS 1st amended	5,859,851.52
Dec 16, 1992	District Court issues second order in Alaska Airlines (denying Government's motion for a stay pending appeal)	

Apr 12, 1993	Federal Circuit grants U.S. request for stay pending appeal to the extent that it permits U.S. to pay monies allegedly owed to Continental into the registry of the Court	
Apr 16, 1993	Bankruptcy Court confirms Continental's Plan	
May 04, 1993	U.S. applies for authority to deposit money with the registry of the Bankruptcy Court	
May 07, 1993	Bankruptcy Court grants motion of U.S.	
May 19, 1993	U.S. deposits $4,763,219.60 with the registry of the Bankruptcy Court	
May 28, 1993 -	GSA amended	(517,042.09)
Jul 02, 1993 -	INS 2nd amended	5,859,955.06
	Net Due United States	**14,508,803.27**

APPENDIX F

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

Case Nos. 90-932 to 90-984

IN RE: CONTINENTAL AIRLINES, INC., ET AL., DEBTORS

ORDER DIRECTING DISBURSEMENT OF FUNDS IN REGISTRY OF COURT TO CONTINENTAL AIRLINES, INC.

THIS MATTER coming on for hearing on September 14, 1993 on the Cross-Motion of Continental Airlines, Inc. for Disbursement of Monies to Debtors and the Court having heard the argument of counsel and now being fully advised, the Court hereby finds and orders that:

This Court has confirmed a plan or reorganization for the Debtors. The first major distribution has taken place thereunder. The Debtors are therefore in a position to seek a final decree in this matter with jurisdiction retained by this Court only as specified in the plan. Since the Debtors have emerged from Chapter 11, Continental Airlines, Inc. is no longer a "bankrupt carrier." Although, at the Court's request, the Court has been informed that similar funds in the cases of Eastern Airlines and Pan Am have not been paid over to the airlines, these cases are distinguishable because they are liquidations, and as such, the carriers are not in a position to reimburse the Government should the Court of Appeals reverse the District Court in the *Alaska Airlines* litigation. The Court understands from the Government's coun-

sel that all other airlines except TWA have been paid by the Government. Since Continental Airlines is no longer in Chapter 11, it should not be treated any differently than the other operating airlines that have been paid; it is therefore

ORDERED that all funds deposited in the Registry of the Court with Wilmington Trust pursuant to the Unopposed Application to Deposit Funds with the Registry of the Court filed by the United States and this Court's Order granting the same, along with all interest accrued thereon, shall be disbursed to Continental Airlines, Inc. forthwith.

DATED this 30th day of September, 1993.

/s/ HELEN S. BALICK
HELEN S. BALICK
United States
Bankruptcy Judge

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 97-7109

IN RE: CONTINENTAL AIRLINES, DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

CONTINENTAL AIRLINES

THOMAS E. ROSS, TRUSTEE

SUR PETITION FOR REHEARING

Before: BECKER, Chief Judge, SLOVITER, STAPLETON, MANSMANN, GREENBERG, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, MCKEE, RENDELL and ROSENN*, Circuit Judges

The petition for rehearing filed by appellant having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not

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* As to Panel Rehearing.

having voted for rehearing by the court en banc, the petition for rehearing is denied.

By the Court,

/s/ ROBERT E. COWEN
ROBERT E. COWEN
Circuit Judge

Dated: March 23, 1998

APPENDIX H

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 97-7109
Civil Action No. 93-cv-00485

IN RE: CONTINENTAL AIRLINES, DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

CONTINENTAL AIRLINES

THOMAS E. ROSS, TRUSTEE

An Appeal from the United States District Court
for the District of Delaware

Argued December 2, 1997
(Opinion Filed January 30, 1998)

Before: COWEN, MCKEE and ROSENN, Circuit Judges

Present: COWEN, MCKEE and ROSENN, Circuit Judges

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of Delaware and was argued by counsel December 2, 1997.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered January 16, 1997, be, and the same is hereby affirmed. Costs taxed against appellant. All of the above in accordance with the Opinion of this Court.

ATTEST:

/s/ Illegible
Clerk

Dated: January 20, 1998

Certified as a true copy and issued in lieu
of a formal mandate on March 31, 1998

Test: /s/ Illegible

Chief Deputy Clerk, United States Court of Appeals for the Third Circuit

APPENDIX I

Section 553 of Title 11, United States Code, provides:

§ 553. Setoff

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

(1) the claim of such creditor against the debtor is disallowed;

(2) such claim was transferred, by an entity other than the debtor, to such creditor—

(A) after the commencement of the case; or

(B)(i) after 90 days before the date of the filing of the petition; and

(ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor was incurred by such creditor—

(A) after 90 days before the date of the filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

(b)(1) Except with respect to a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(14), 365(h), 546(h), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—

(A) 90 days before the date of the filing of the petition; and

(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

(c) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

Section 1141 of Title 11, United States Code, provides:

§ 1141. Effect of confirmation

(a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—

(A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section

502(g), 502(h), or 502(i) of this title, whether or not—

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

(3) The confirmation of a plan does not discharge a debtor if—

(A) the plan provides for the liquidation of all or substantially all of the property of the estate;

(B) the debtor does not engage in business after consummation of the plan; and

(C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

(4) The court may approve a written waiver of discharge executed by the debtor after the order for relief under this chapter.